

**FACTORS AFFECTING WORKING CAPITAL
MANAGEMENT PRACTICES IN SMALL AND MEDIUM
ENTERPRISES IN NAIROBI**

BY

JEAN PAUL NDAGIJIMANA

UNITED STATES INTERNATIONAL UNIVERSITY

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

UNITED STATES INTERNATIONAL UNIVERSITY

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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 the United States International University in Nairobi for academic credit.

Signed: _____ **Date:** _____

Jean Paul Ndagijimana (ID 601774)

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

Signed: _____ **Date:** _____

Dr. Timothy Okech, PhD

Signed: _____ **Date:** _____

Dean, Chandaria School of Business

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LIST OF ABBREVIATIONS AND ACRONYMS

AP: Accounts Payables

AR: Accounts receivables

CCC: Cash conversion cycle

GoK: Government of Kenya

MBA: Masters of Business Administration

USIU: United States International University

KEPSA: Kenya Private Sector Association

SMEs: Small and Medium Enterprises

ABSTRACT

The main purpose of this study was to investigate the factors affecting working capital management practice in small and medium enterprises in Nairobi. In order to realize this, three research questions guided the process. These were i) to what extent does management of accounts receivable affect working capital management practice in small and medium enterprises in Nairobi? ii) to what extent does the management of accounts payable affect working capital management in small and medium enterprises in Nairobi? and iii) how does the cash conversion cycle affect working capital management in small and medium enterprises in Nairobi? To realize this, a descriptive research design was adopted. The total population of this study comprised of all registered SMEs in Nairobi with the Federation of Small and micro enterprises estimated at four hundred and twenty six from which a sample of eighty four was drawn using simple random sampling. Data was collected using structured questionnaire with the assistance of trained research assistants. Data collected was cleaned, coded and formatted before being analyzed using SPSS to obtain both descriptive and inferential statistics.

The study revealed that accounts receivable management affect working capital management practice in small and medium enterprises in Nairobi. It was evident that majority of the respondents (73.3 percent), get their raw materials locally, while it was also revealed that SMEs lack requisite inventory management tools that could be essential in the reduction of pile up of raw materials. In the same regard 76.7 percent agreed, that indeed they keep records of goods and materials and finally majority for the SMEs were seen to carry out stock taking daily. Regression results also showed a positive relationship between accounts receivables and working capital management practice in SMEs.

The study further revealed that accounts payable management affect working capital management in small and medium enterprises in Nairobi. Additionally the study revealed that credit purchase has been adopted largely in the SME sector. Respondents also agreed that they are allowed a credit period that range from 7 days to more than 21 days. Similarly respondents agreed that they indeed negotiate with debtors to the extent of the credit period. A regression analysis showed a positive significant relationship between

accounts payable management and working capital management. Finally it was revealed that cash conversion cycle management affect working capital management in small and medium enterprises in Nairobi. Additionally majority of the SMEs were seen to have gotten their finances from banks, friends and self-financing respectively. In the same regard, it was revealed that SMEs have cash targets though most of them simply keep their cash in cash tills, while a few others spend their proceeds.

The study recommends that SMEs need to be cautious about their accounts receivables position given that if this is not properly managed, there is likelihood that it will dwindle their performance. In this regard therefore the study recommends that SMEs need to balance between credit sales and cash sales so as to avoid running into a put into cash strap position. The study also acknowledges the important role played by accounts payable in working capital management practice and as such the study recommends the need for SMEs to put in place tools to effectively manage accounts payables so as to enhance the efficiency off the business process and to avoid the challenges that are likely to emanate from overreliance on debts. Finally, the study recommends that SMEs should adopt the culture of standard liquidity position so as to reduce the risk of losses as a result of too much cash at the business place which might dent the performance of SMEs.

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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Problem

Various definitions have applied by various stakeholders with reference to SMEs. For instance, while Sessional Paper No. 2 of 2005 defines a SME as an enterprise with between 1 to 50 employees, the World Bank uses various criteria to define SME. These include a formally registered business with an annual turnover of between Ksh. 8 - 100 million or with an asset base of at least Kenya Shillings 4 million; or employing between 5 - 150 employees. Researchers from various disciplines agree about the importance of small business to economic growth and personal wealth (Autio, 2005). The small business sector as a major source of employment and income is argued to be even more important to the economies in developing countries.

Over the years, small and medium enterprises (SMEs) development has emerged a major economic development and growth strategy aimed at in poverty alleviation, wealth and employment creation in many world economies. As a result, many governments worldwide with support from sectoral partners have continued to initiate programs earmarked towards the strengthening and development of the sector (Okech, 2006). Areas of support include management and technical training, extension services, provision of physical structures, provision of lack and utilities, marketing and credit facilities (Okech 2006; GoK, 2010). Aware of this, the Kenyan government has taken steps to develop a legal, and regulatory framework, markets and marketing, business linkages, the tax regime, skills and technology and financial services (GoK, 2005; GoK, 2010).

In Africa, about 25 percent of the people employed outside agriculture depend on this sector for their livelihood; improving the conditions for small business is thus seen as a solution to unemployment and poverty alleviation (Mead & Liedholm, 1998). According to Haftendorn and Salzano (2003), micro and small enterprise creation are routes that young people actively explore to ark their current and future economic needs. In Kenya, the sector contributed over 50% of new jobs created in 2005 and contributed estimated 18 per cent of GDP, up from 3 per cent in 2010 (GoK, 2012). The Government of Kenya in Kenya's

blue-print of 2010 acknowledged Kenya to move towards a newly-industrialized middle-income country capable of providing a high quality of life for all its citizens by the year 2030, SMEs need to be strengthened (GoK, 2010).

Despite the significant contribution and support earmarked towards the sector, SMEs are faced with the threat of failure with past statistics indicating that three out of five fail within the first few months (Sonia, 2009; Nzyoka, 2011). According to Sonia, working capital management accounts for most of the failures in these enterprises. The extensive literature on the subject reveals the component of working capital consisting of current assets and current liabilities. The need to main effective working capital management within small and medium enterprises remains pivotal to solvency and liquidity of SME's (Pieteron, 2012). Most SMEs do not care about their working capital position, most have only little regard for their working capital position and most do not even have standard credit policy. Many do not care about their financial position, they only run business and they most focus on cash receipt and what their bank position is (Sunday, 2011)

For the viability of the enterprises, Banos *et al* (2010) observed that efficiency in the management of working capital is critical. This according to Banos *et al* will enhance performance of the SMEs as well their sustainability and competitiveness. They noted that their viability will depend to a greater extent, on the ability of the enterprises to effectively manage receivables, inventory and payables (Bano *et al.*, 2010). The goal of working capital management is to ensure that affirm is able to continue its operations and that it has manage its short term obligations when they occur. According to Pieteron (2012), however, most SMEs fail to maintain necessary financial transactions which in the process affect their working capital and hence encounter cash flow problems.

There often exists a mismatch between cash inflows and cash outflows during operating activities in SMES. To control these cash flows and thereby reduce the potential negative effects on profitability and risk, it is important that working capital management is applied. This is important because SMEs have more volatile cash flows, are less liquid, are more dependent on short term financing and are faced with higher

portions of current assets compared to large companies (Ross, Westfield and Jaffe (2005).

In Peel and Wilson (1996) it was reiterated that small and medium enterprises should adopt formal working capital management routines in order to reduce the probability of business closure, as well as to enhance business performance. They contended that managers and entrepreneurs of these enterprises should understand the importance of working capital management for the liquidity, profitability and ultimately the survival of their company.

1.2 Statement of the Problem

Studies reveal high levels of collapse of the SMEs soon after their establishment with many of these pointing out existence of short term debts (Nzyoka, 2011; Pieteron, 2012). For instance, according to Pieteron (2012) many of these enterprises have problems of managing their working capital partly attributed to inadequacy in financial management, especially the working capital management. The combination of account receivable management, cash management and account payable strategies were specifically singled out. The need to maintain effective working capital management within small and medium enterprises remains pivotal to solvency and liquidity of SMEs as observed by Kehinde (2010). Kehinde noted that most SMEs have very little concerns for their working capital position with no policy for the management of the same as well as credit issues. He further observed that many do not care about their financial position, they only run business, and that they mainly focus on cash receipt and the bank account position. In the end this has negatively impacted on their subsequent sustainability.

In Westerfield & Jaffe (2005), it was reported that there exist a mismatch between cash inflow and cash outflow during operating activities in small enterprises. To control these cash flows and thereby reduce the potential negative effects on profitability and risk, it is important that working capital management tools and techniques are adopted contended Westerfield & Jaffe. This in the process will improve their value making decisions on working capital implies making a tradeoff among profitability and risk.

Anita (2012) on the other hand observed that in many SMEs, profits and cash flows are volatile and they are less liquid which affect their viability (Anita, 2012).

As noted by Faff (2009) limited attention has been accorded to the understanding the factors affecting the working capital management in small and medium enterprises. A few existing studies have mainly concentrated on larger firms but there is no evidence from small and medium-size enterprises (Chiou *et al.*, 2006). To gain empirical insight into these factors, there was thus need to examine factors affecting management of working capital in small and medium enterprises in Nairobi.

1.3 Purpose of the Study

The purpose of the study was to examine factors affecting working capital management in SMEs in Nairobi.

1.4 Research Questions

The study was guided by three specific research questions namely:

1.4.1 To what extent does management of accounts receivable affect working capital management practice in small and medium enterprises in Nairobi?

1.4.2 To what extent does the management of accounts payable affect working capital management in small and medium enterprises in Nairobi?

1.4.3 How does the cash conversion cycle affect working capital management in small and medium enterprises in Nairobi?

1.5 Importance of the Study

1.5.1 Investors

The finding on management of receivables will provide useful information for assessing why majority of SME's fails to collect their payments in good time and help SME investors to adopt mitigating strategy.

1.5.2 Suppliers

The findings on payable management will provide useful information on why SMEs failing to honor their obligation to their suppliers and give insights on how SME's could create a short term financing to their businesses through effective accounts payable management.

1.5.3 Policy makers

The findings cash conversion management will help stakeholders in SME industry to design and implement procedures and policies that may assist in effectively managing their cash at hand and cash in bank.

1.6 Scope of the Study

The study covered apportion of the small scale and medium enterprises in Nairobi. The study however was limited to the period of May and July 2014, and the events and happenings within this study period were considered in the study.

1.7. Definitions of Terms

1.7.1 Small and Medium Enterprises (SMEs)

This is considered as a small business as that with 10-99 employees as well as using the annual turnover and the annual balance sheet after all rebates have been paid out (GoK, 2007)

1.7.2 Working Capital

Defined as current assets less current liabilities (Khan & Jain, 2007).

1.7.3 Cash Conversion Cycle

Reflects the time interval between actual cash expenditure on a firm's purchase of production of resources and the time it takes to recover the sales proceeds (Reeve *et al.*, 2012).

1.7.4 Account Payable Management

Accounts payable is one of the major sources of un-secured short-term financing (Gitman, 2009).

1.8 Chapter Summary

This chapter has provided the background of the problem, stated the problem, established the purpose of the study, elaborated on the research questions, stated the importance of the study, delimited the scope of the study and has defined terminology that will be used in the study. The next chapter provides literature review followed by methodology in chapter three, results and findings in chapter four and finally summary, discussions, conclusion and recommendations in chapter five.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

In this chapter review literature relating to factors affecting working capital management in small and medium enterprises is presented based on the research objectives. The first subsection provides literature on the management of account receivable followed by literature on the management of account payable and finally, the cash conversion cycle.

2.2 Accounts Receivables Management and Working Capital Management

The study first sought to what extent management of accounts receivable affect working capital management practice in small and medium enterprises in Nairobi. The following subsection presents a summary of reviewed literature with regards how accounts receivables management affects working capital management.

2.2.1 Trade Receivable Management

A research carried out by Bowen and Mureithi (2009), on management of business challenges among small and Micro Enterprises in Nairobi revealed that debt collection ranks among the top three challenges small and micro enterprise owner operating in Nairobi face in their businesses (Bowen & Mureithi, 2009). Receivables are claims held against customers and others for money, goods or services. For financial statement purposes, receivable are classified as either current (short term) or non-current (long term). Current receivables are expected to be collected within the current operating cycle Receivables are further classified in the balance sheet as either trade or non-trade receivable (Gitman, 2009). Trade receivables are amounts owed to customers for goods sold and services rendered as part of normal business operations.

Trade receivables are frequently classified as accounts receivable, and note receivables. Non trade receivables are receivables that do not result from the core business of the small enterprise (Sunday, 2011). Khan (2007), on the other hand maintains that accounts receivables are promises of the purchaser to pay for goods and service sold. They are

normally collectible within thirty to sixty days and represents “open accounts” resulting from short term extension of credits. Although an SME enters into credit sale transactions with the intention of collecting the full amount of sale within sixty days or less, the economic reality is that the SME will not collect on its entire credit sale and some of receivable will never be collected. Handling accounts receivable therefore can prove to be a very difficult process, particularly when dealing with collecting overdue accounts.

To help maintain a steady cash flow and deal effectively with business credit Sunday, (2011) noted that accounts receivables should be recorded and paid when due. To ensure that receivables are not overstated on the balance sheet, which has negative tax implications; best practice requires that receivables are stated at their net realizable value by reducing its amount receivable by the amount it estimates it will not collect either by using percentage of sales on its income statement or by using the aging of the account receivable on the balance sheet.

2.2.2 Notes Receivables Management

Notes receivable are frequently accepted from customers who need to extend the payment period of an outstanding receivable. Notes are also sometimes required of high-risk or new customers. In addition, notes are often used in loans to employees and subsidiaries and in the sales of property, plant and equipment. A note receivable is supported by a former promissory note, a written promise to pay a certain sum of money at a specific future date. Such a note is a negotiable instrument that is signed by a maker, in favor of a designated payee who may legally and readily sell or otherwise transfer the note to others. Although notes contain an interest element because of the time value of money notes are classified as interest bearing or non-interest bearing (Gitman, 2009).

Notes receivable represents a claim for which a formal instrument of credit sometimes referred to as a promissory note is issued as evidence of debt. Credit instruments normally require payment of interest and extend for time period of 60 to 90 days sometimes longer. When the note is paid according to the terms, the note is honored.

When the note is not paid according to the term, the note is dishonored and the amount due, including the interest earned, and unpaid is recorded as receivable. At the end of the accounting period, in order to comply with the matching principle, interest must be accrued for the number of days between the most recent interest payment date and the end of the accounting period (Sunday, 2011).

2.2.3 Effects of Trade Receivable Management

Non trade receivables arise from a variety of transactions and can be written promises either to pay or deliver. Some examples of non-trade receivables are: interest receivable, loans to officers, advances to employees, deposit to cover potential damages or loss, deposit as a guarantee of performance or payment, dividends receivables, claims against insurance companies, government bodies for tax refunds, creditors for returned, damaged or lost goods, customers for returnable items such as crates or containers, etc. Because of the peculiar nature of non-trade receivables, they are generally classified and reported as separate items in the balance sheet (Nazir, 2008).

To handle accounts receivables effectively, SME investors will need to consider the following factors when setting up their account receivable process: Properly maintaining customer details and credit information; appropriate credit terms and billing cycle – faster you bill, the faster you get paid; providing small discounts to encourage early payment; developing and maintaining age receivable schedules, regularly review age receivables and monthly customer statements and implement policies to ensure timely and efficient collection of outstanding accounts, such as making follow up phone calls or setting reminders (Connolly, 2013).

A number of studies have been conducted to examine how accounts receivable management affects working capital management of SMEs. A study by Lazaridis and Dimitrios (2005) established that indeed firms pursuing increased levels of accounts receivables are likely to increase their profitability as a result of an increase sales and market share. Additionally a study by Juan and Martinez (2002) made a revelation of how firms can create value through the reduction of their number of days of accounts receivable, a revelation that was also affirmed by a study conducted by Deloof (2003)

who found out that indeed the length of receivables collection period is negatively related a to the performance of the firm.

A study done Sushma and Bhupesh (2007) also made an affirmation on how putting in place a sound credit policy is likely to ensure that proper debt collection procedures and is therefore pivotal when it comes to efficiency in receivables management hence the performance of the firms.

Falope and Ajilore (2009) while using a panel data econometrics in a pooled regression, of SMEs in Nigeria. They established a significant negative relationship between net operating profit on one hand and the average collection period (ACP) as well as average payment period (APP).

Mathuva (2009) on his study in Kenya examined the influence of receivables and payables management on corporate profitability. He used Pearson and Spearman's correlations, the pooled ordinary least square (OLS), and the fixed effects regression models to conduct data analysis. He was able to establish a highly significant negative relationship between the ACP and Profitability. Additionally he established that indeed there exist a highly significant positive relationship between the APP and profitability.

Baveld (2012) conducted a study on if indeed there exists a relationship between profitability and accounts receivables in the period of the global crisis. The main aim of his study was to investigate the extent to which public listed firms in the Netherlands manage their working capital. The study made a comparison of two periods; the non-crisis period of 2004-2006 and the financial crisis period of 2008 - 2009. The findings revealed that there exists a significant negative relationship between accounts receivables and gross operating profit during non-crisis period. Consequently, during crisis period, there was no significant relation between these two variables. The findings of this study is proof of how there exists a relationship between accounts receivables and firm's profitability in the wake of changing times of a crisis. This is an indication of how some firms need to keep their accounts receivables at minimum so as to be able maximize profitability during crisis periods.

2.3. Accounts Payable Management and Working Capital Management

2.3.1 Accounts Payable Management and Overall Operational Effectiveness

Management of payables is an important factor in an SME's working capital management, and a key indicator of overall operational effectiveness. If it's too high, the SME may soon have trouble paying bills on time, leading to costly penalties; if it's too low, the SME could unwisely be paying bills early, rather than enjoying the full grace period and investing any surplus cash into the business. In managing payables, timeliness and accuracy are critical. They create continuity and consistency, and builds trust with your vendors and stakeholders, while enabling your organization to function properly (Tagoe, 2008).

A research carried out by Sunday (2011), on effective working capital management in small and medium scale enterprises revealed that most SME suffer from the problem of paying all bills/cash outflow from cash earnings which most of the time. He maintains that for most SME's the production and sales cycle is shorter than the average age of accounts payable, creating a scenario where trade debt builds up in an ever increasing manner until a point where the SME cannot pay debts in due date, and eventually collapses (Kehinde, 2011).

Accounts payable, or trade account payable, are balances owed to others for goods, supplies, or services purchased on open account. Accounts payable arise because of the time lag between the receipt of services or acquisition of title to assets and the payment for them. This period of extended credit is usually found in the terms of the sale (e.g., 2/10, n/30 and is commonly 30 to 60 days. Notes payable are written promises to pay a certain sum of money on a specified future date and may arise from purchases, financing, or other transactions (Hill, 2010).

An accounts payable turnover ratio measures the number of times a company pays its suppliers during a specific accounting period. It is an accounting liquidity metric that evaluates how fast a company pays off its creditors (suppliers). The ratio shows how many times in a given period (typically 1 year) a company pays its average accounts

payable. Accounts payables turnover trends can help a company assess its cash situation (Sunday, 2011).

Just as accounts receivable ratios can be used to judge a company's incoming cash situation, the account payable ratio can be used to demonstrate how a business handles its outgoing payments. A high ratio means there is a relatively short time between purchase of goods and services and payment for them, and a lower accounts payable turnover ratio usually signifies that a company is slow in paying its suppliers (JICA, 2008). SME's unpaid bills can have a big impact on its profitability. They can either improve the SMEs' profitability or they can cause it to really take a hit. Two primary ways that accounts payable affect SME's profitability are the SME's relationships with its suppliers or vendors and the company's cash flow (Khan, 2007).

2.3.2 Account Payable Management and Supplier Relationship

It is crucial that SME's operations maintain good relationships with their suppliers. The single most important thing an SME can do to maintain good supplier relationships is to pay its bills on time, especially as the SME grows and its suppliers grow it is inevitable that the number of invoices to be paid will grow proportionately. Supplier relationship management involves a mutually beneficial relationship between the company and each supplier (Nazir, 2008).

Good supplier relationships provide a win-win situation for the company and the supplier. Suppliers will cut good deals for the company. They will suggest new and better products to the company. They will work with the company on delivery times and policies. Good supplier relationships mean increased company efficiency. If the SME pays its bills on time, actively cultivates good relationships with its suppliers, doesn't cut off suppliers with no reason, and keeps lines of communication open, a good supplier should then offer the SME the best trade credit terms possible and good trade credit terms will maximize the SME's profitability (Chandra, 2008).

2.3.3 Accounts Payable Management and Business Cash flow

A fully functioning cash flow is crucial to the smooth turning of the business wheel. Companies which apply best practices manage accounts payable so that the process both contributes positively to the cash flow, and supports mutually beneficial relationships with suppliers (Peterson, 2012). A company with smooth running, streamlined accounts payable operations is able to save money by processing invoices with a minimum number of staff and with a low cost of materials. It's not really possible to achieve this without some level of automation and taking the paper out of the function with an e-invoicing solution enables accounts payable departments to closely monitor their cash flow, and if they're on the ball, extract powerful metrics (Tagoe, 2008).

The cash flow can be controlled by minimizing late payment costs such as late payment penalties, interest charges and lost early settlement discounts – and by adhering to efficient best practice operations. In addition, as banks remain reluctant to lend, organizations are looking at more innovative ways to increase cash flow from investigating how dynamic discounting can help their supply chain (Abor, 2010). Many European organizations are also using invoice financing (or factoring) as a way of maintaining control over working capital whereby, with Reverse Factoring, the buyer approves the invoice prior to the financing organization settling with the supplier, enabling financing of 100% of the invoice value (Appuhami, 2008).

2.3.4 Accounts Payable Management and Profitability

Wilson, et al (2007) while carrying out an empirical study of the demand for trade credit by small UK firms, established the existence of strong evidence regarding a financing demand for trade credit. They established that small firms, which pay trade credit liabilities late do so in times when they reach their limit on short-term bank finance. These means therefore that credit rationed firms are typically growing and export oriented. It follows therefore, that severe liquidity problems are likely to occur and as such an increased failure rates unless alternative finance is readily available.

A number of studies have shown a positive significant relationship between accounts payable management and profitability of firms, for instance Deloof (2003) examined

1009 large Belgian non-financial firms for 1992-1996 periods and established that indeed that managers are likely to increase the profitability of firms if they put in place mechanisms to reduce the days in accounts receivable and inventories. He therefore infers that research less profitable firms stretch their accounts payable.

Nobanee and AlHajjar (2009) carried out an analysis on 2,123 Japanese non-financial companies which had been listed in the Tokyo Stock Exchange between 1990 and 2004 and made a conclusion that company managers have in their hands the choice to increase profitability through shortening of the cash conversion cycle, the receivables collection period as well as the inventory conversion period. These results therefore put forward a suggestion that extending the payables deferral period could increase profitability.

However, managers should be careful because extending the payables deferral period could damage the company's credit reputation and harm its profitability in the long run. Delaying payments to suppliers allows companies to assess the quality of the products that were bought and can be an inexpensive and flexible source of financing. But we should bear in mind that late payment can have a very high implicit costs whenever early payment discounts are available. Since money is also locked up in working capital, the greater the investment in current assets, the lower the risk but also the lower the profitability obtained (Falope and Ajilore, 2009).

García-Teruel *et al* (2007) were considered to be among the first to make an experimental analysis with regards the effects of accounts payable management on the Profitability of Small and Medium Enterprises or SMEs. Their study provided a display of a very significant negative relationship between the Return on Assets and the number of days accounts payables. Zariyawati *et al* (2009) also carried out a study to investigate the relationship between corporate profitability and accounts payable management of firms in six different Economic Sectors of the Malaysian Industry. The study led to an indication that most of the previous studies, in their opinion, focused on large and/or developed markets. Thus reinvestigating the issue in the emerging markets of is likely to provide further insight on the impact of working capital management on profitability. Their results also were indicative of a strong and significant negative association between the two variables of study.

2.4 Cash Conversion Cycle and Working Capital Management

2.4.1 Cash Conversion Cycle and Liquid Cash

A business's operating cycle is simply the number of days its goods are tied up in inventory plus the number of days its sales are tied up in receivables. The cash conversion cycle then is a measure of how efficiently accompany operates. But more importantly is a measure of cash creation efficiency in the business (Ternel, 2007). Abel (2008) in his research on the impact of working capital management on cash holding of small and medium enterprises in Sweden, he discovered that efficient working capital management is related to the levels of cash holdings. In the same regard, it was established that cash conversion cycle is the number of days negotiated financing is needed to support the operation cycle of a business.

Cash is the most liquid of assets. It is the standard medium of exchange and the basis for measuring and accounting for all other items and is generally classified as a current asset. To be reported as cash it must be readily available for the payment of current obligations, and it must be free from any contractual restriction that limits its use in satisfying debts (Garcia, 2010).

Calculating the cash conversion cycle, sometimes called the asset conversion cycle, tells you a lot more about ability to pay than the quick or current ratio. Using the average number of day's inventory, receivables and payables are tied up gives clear meaning that is easy to understand. By using the average days method, the how do I make improvements to my process question, is also easily answered by most managers (Hill, 2010).

Cash consists of coin, currency, and available funds on deposit at the bank. Negotiable instruments such as money orders, certified checks, cashier checks, personal checks, and bank drafts are also viewed as cash. Savings accounts are usually classified as cash, although the bank has the legal right to demand notice before withdrawal. Money market funds that provide checking account privileges are also classified as cash. Petty cash funds and change funds are included in current assets as cash because these funds

are used to meet current operation expenses and to liquidate current liabilities (Chandra, 2008).

Cash is the asset most susceptible to improper diversion and use. Two problems of accounting for cash transactions face management. The first is to ensure proper controls have been established to ensure that no unauthorized transactions are entered into by officers or employees; and secondly to ensure that information necessary to the proper management of cash on hand and cash transactions are provided. Yet, with sophisticated control devices errors can and do happen (Connolly, 2013).

To safeguard cash and to ensure accuracy of the accounting records for cash, effective internal controls over cash is imperative. There are new challenges to maintaining control over liquid assets as more and more transactions are conducted with the swipe of a debit or a credit card. In addition, electronic commerce conducted over the internet continues to grow. Each of these trends contributes to the shift from cold cash to digital cash and poses new challenges for the control of cash (Hill, 2010).

2.4.2 Effects of cash conversion cycle on cash equivalent

Cash equivalent are short term, highly liquid investments that are both readily convertible to known amounts of cash, and so near their maturity that they present insignificant risk of changes in interest rates. An example of this would be things like treasury bills, commercial papers and money market funds (Khan, 2007).

Hill (2010) maintains that the cash conversion cycle simply indicates the duration of time it takes the firm to convert its activities requiring cash into cash returns. Therefore, a downward trend in this cycle is a positive signal while an upward trend is a negative signal. Why is this so? When the cash conversion cycle shortens, cash becomes free for other uses such as investing in new capital, spending on equipment and infrastructure, as well as preparing for possible share buybacks down the road. On the flip side, when the cash conversion cycle lengthens, cash remains tied up in the firm's core operations, leaving little leeway for other uses of this cash flow.

According to Khan (2007) the Cash Conversion Cycle or Net Operating Cycle tells us how many days it take a company to pay for and generate cash from the sales of its inventory. It gives an indication as to how long it takes a company to collect cash from sales of inventory. Often a company will finance its inventory instead of paying for it with cash up front. This means they owe someone money which generates “Accounts Payable”. Many times they will turn around and sell that inventory on credit without getting all the cash at the time of the sale. This means people owe them money and generates “Accounts Receivable”.

The formula for the Cash Conversion Cycle is Days of Sales Outstanding plus days of Inventory Outstanding minus days of Payables Outstanding. The entire Cash Conversion Cycle is often referred to as the Net Operating Cycle. It is “net” because it subtracts the number of days of Payables the company has outstanding from the Operating Cycle. The logic behind this is that Payables are really viewed as a source of operating cash or working capital for the company. By contrast, Receivables, or cash the company has not received yet, decreases working capital available to the company to finance operations (Ternel, 2007).

According to Peterson (2012), days Sales Outstanding or DSO can be described as average Accounts Receivable divided by Revenue per day. In finance, whenever we use ratios that mix Balance Sheet numbers (Accounts Receivable) with Income Statement numbers (Revenue) we should average the Balance Sheet numbers from the beginning and end of the period. This is because the Income Statement measures activity that takes place over the entire period, whereas a Balance Sheet is the valuation of the various accounts on a particular day (usually the end of the period).

Average Accounts Receivable would be Accounts Receivable at the beginning of the period plus Accounts Receivable at the end of the period divided by two. Similarly, Revenue per day would be Revenue for the year divided by 365. The complete formula therefore would be: $DSO = [(BegAR + EndAR) / 2] / (Revenue / 365)$ DSO tells you how many days after the sale it takes people to pay you on average. You want to get paid by your customers quickly, so a lower number is better but as always this needs to be taken

in context. You don't want to make your customers pay so quickly that they buy from someone else with less aggressive collection policies (Nazir, 2008)

According to Hill (2010) days of Inventory Outstanding, or DIO, is similar to DSO but instead of comparing Sales per day relative to average Receivables it looks at Cost of Goods Sold per day relative to average Inventory levels. The formula would look like this: $DIO = [(BegInv + EndInv / 2)] / (COGS / 365)$ DIO, sometimes referred to Days of Inventory on Hand and abbreviated DOH (Homer Simpson), tells you how many days inventory sits on the shelf on average. For the most part, you want to see your inventory flying off the shelves, so again a lower number is better, but not so low that you don't have sufficient inventory and are missing potential sales.

The first two components of the CCC, DSO namely DIO are what is called the Operating Cycle. These are how many days it takes for a company to process raw material and/or inventory and collect cash from the sale. $Operating\ Cycle = DSO + DIO$. Basically the Operating Cycle tells you how many days it takes for something to go from first being in inventory to receiving the cash after the sale. You want this number to be low meaning that merchandise isn't sitting on shelves too long and customers are paying relatively quickly (Appuhami, 2008).

According to Chandra (2008) days of Payables Outstanding or DPO is the final component of the Net Operating Cycle and it gets subtracted from the Operating Cycle (hence the "net"). It measures the number of days of Accounts Payable the company has outstanding relative to their purchases of inventory or COGS. The formula is: $DPO = [(BegAP + EndAP) / 2] / (COGS / 365)$.

Days of Payables Outstanding tells you how many days the company takes to pay its suppliers. Unlike the other two numbers that make up the Operating Cycle, the company wants to stretch out how long it takes to pay for its inventory. In reality it is a form of free vendor financing and free is good! But once again, this is within context of each specific company. The company, for instance, wouldn't want to take so long to pay that it missed out on big discounts for paying early or incentives offered if there are any (Abor, 2010).

According to Garcia (2010) speculative trading bubbles will likely come and go, and pure anxiety and sentiment from investors of all sizes will always factor into the market. It is, however, no secret that to pick a solid performer when the market is slow or under attack takes a little more know-how. The cash conversion cycle can tell you how cash is moving through a company in terms of duration. This ratio is vital because the cycle represents the number of days a firm's cash remains tied up within the operations of the business. The cash conversion cycle is a derived ratio and is generally not part of ratio comparison sections found in financial portals or websites. You can, however, construct the three ratios that compose the calculation of the cash conversion cycle by taking a little time to look at a firm's inventory, receivables and payables (Ternel, 2007).

According to Tagoe (2008) entrepreneurs should pay attention to the trend of its three general components with special emphasis on the payables processing period in taking the time to find the cash conversion cycle. Sometimes shorter processing periods for inventory and/or receivables can be largely offset by increases in the processing period for accounts payables. The processing period for accounts payables will increase if the firm is paying its creditors and suppliers at a slower rate.

Peterson (2012) maintains that the main point to remember, however, is that an understanding of each of the three factors in the formula can help pinpoint the trend not only in the cash conversion cycle but also in the individual processing periods themselves, insights that can give both a synopsis of operational efficiency and the justification behind it. As a stand-alone number, Cash Conversion Cycle doesn't mean very much. Instead, it should be used to track a company over time and to compare the company to its competitors.

2.4.3 Cash Conversion Cycle and Management Effectiveness

Cash Conversion Cycle is one of several tools that can help you evaluate management, especially if it is calculated for several consecutive time periods and for several competitors. Decreasing or steady Cash Conversion Cycles are good, while rising ones should motivate you to dig a bit deeper. Cash Conversion Cycle is most effective with retail-type companies, which have inventories that are sold to customers. Consulting

businesses, software companies and insurance companies are all examples of companies for whom this metric add little value (Nazir and Afza, 2008).

According to Appuhani (2008), the traditional link between the cash conversion cycle and the firm's profitability is that shortening the cash conversion cycle increases firm's profitability. On the other hand shortening the cash conversion cycle could harm the firm's operations and reduces profitability. This could happen when taking actions to reduce the inventory conversion period, a firm could face inventory shortages; when reducing the receivable collection period a firm could lose its good credit customers; and when lengthening the payable deferral period a firm could harm its own credit reputation. However, identifying optimal level so inventory, receivables, and payables where total holding and opportunities cost are minimized and recalculating the cash conversion cycle according to these optimal points provides more complete and accurate insights into the efficiency of working capital management. In this regard, we suggest an optimal cash conversion cycle as more accurate and comprehensive measure of working capital management (Arbor, 2010).

2.5 Chapter Summary

In the chapter, detailed review of literature based on the research objectives has been documented. The next chapter provides the research design and methodology followed by study findings and interpretation in chapter four. The last chapter provides the summary, discussions and conclusion of the findings followed by recommendations based on the findings.

CHAPTER THREE

3.0 RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This Chapter provides the research design and methodology. Specifically, in the chapter, the design adopted is provided followed by the target population and sampling frame, sampling design and sample size. Other sub-sections include data collection instruments and research procedures, and finally data analysis.

3.2 Research design

The study adopted a descriptive research design, in view of the facts that, it is a study of relatively short duration and it involves a systematic collection and presentation of data to give a clear picture of a particular situation. Descriptive research has three main objectives which have made it the most appropriate research design for this research which are: helps discover whether a relationship exists between variables, helps determine the frequency of occurrence and finally describes the state of a variable (Cooper and Schindler 2013). It was aimed at getting relevant information related to factors affecting working capital management of small and medium scale enterprises in Nairobi. The independent variable of the study was working capital management practices while the independent variables included accounts payable management, accounts receivables management and cash cycle management.

3.3 Population and Sampling Design

3.3.1 Population

According to Saunders, Lewis and Thornhill (2012), population is the complete set of cases or group members. The population of the study consisted of small and medium scale enterprises registered with the Kenya Private Sector's alliance under the Micro and small enterprise federation (MSEF). The focus was on the association members in the commercial business district of Nairobi and categorized the sample into sectors based on

the nature of their operations. The estimated total population was four hundred and twenty six (426).

3.3.2 Sampling Design

3.3.2.1 Sampling Frame

According to Tryfos (1996), sampling frame is the list from which the samples are drawn, ideally the frame should be the target population. The sampling frame was consisted of all SME's registered by the Kenya Private Sector Alliance under the Micro and Small enterprise Federation (MSEF) which has small and medium enterprises categorized in various sectors in various counties. The population frame was the list of all small and medium enterprises registered by MSEF in Nairobi County that are involved in Trade and services, manufacturing and agribusiness obtained from the MSEF registry.

3.3.2.2 Sampling Technique

This refers to the methods used in drawing samples from a population in a way that the sample selected will help determine a stated hypothesis in regards to the population as stated by Cooper and Schindler (2013). A r a n d o m l y sampled quota of the registered members of the association was studied. The descriptions of the SMEs by the nature of their business constituted strata.

3.3.2.3 Sample size

A sample is a smaller group or subgroup obtained from the accessible population (Mugenda and Mugenda, 2003). This subgroup is carefully selected to be representative of the whole population with relevant characteristics. As such, the sample size ensures that the information is detailed and comprehensive. Due to some limitations especially associated with time and cost, the whole population was not studied. Using simple random sampling, eighty four enterprises were selecting for study.

Table 3.1: Sample Size

Population	Sample Size	Percent
CBD	24	28%
Suburb	30	36%
Open Market	30	36%
Total	84	100%

3.4 Data Collection Methods

Both primary and secondary data were collected to facilitate the realization of the study objectives. Secondary data was obtained from SMEs reports, Annual Financial statements, Budgets and Monetary records, Cash-flow statement, Asset register, Tax schedule among others. On the other hand, primary data was collected largely collected using a structured questionnaire. The questionnaires were self-administered to all the respondents in the sample size and had both open ended and closed ended questions. Whereas the closed ended questions were necessary for ease of coding, closed ended were necessary for purposes of clarification.

The information obtained from questionnaires was free from bias and researchers influence and thus accurate and valid data was gathered. The questions addressed by the questionnaires sought to gather descriptive data on the basis of the research objectives. The first part of the questionnaire sought information on the background of the respondents as well as the SMEs involved in the study. The second and subsequent sections sought information with regards to the three specific objectives of the study. The Likert Scale was also used such that it provides room for the respondents to indicate the degree to which they agree/disagree with various statements.

3.5 Research Procedures

First, four research assistants were recruited, trained on the tools. Thereafter they were involved in the pilot-testing of the tools to ensure the validity and reliability of the tools. Respondents in the pretest were drawn from four SMEs. They were asked to evaluate the questions for relevance, comprehension, meaning and clarity. The research instrument was thereafter modified on the basis of the pilot test before administering it to the study respondents. In order to ascertain the reliability of the research instrument, Cronbach Alpha was used to test reliability of the instrument and the cutoff point of 0.538 was considered. Questionnaires were thereafter distributed followed by a follow up to a cross section of respondents, while others were contacted by phone in order to help them with the filling of the questionnaire. The third visit was used to collect the questionnaire.

3.6 Data Analysis Methods

The collected data was analyzed using both quantitative and qualitative data analysis approach. The data gathered from the field of study was reviewed to ensure accuracy and completeness. Thereafter, it was coded and analyzed using SPS to obtain both descriptive and inferential statistics. These were in terms of frequency tables, charts, means and regression statistics.

3.7 Chapter Summary

In the chapter, research design and methodology have been explained. The next chapter provides results and findings, followed by the summary, discussion, conclusion and finally recommendations.

CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter presents the results and findings of the study on the research questions with regards to the data collected from the respondents. The first section presents the background information with regards to the respondents. The second and subsequent sections present a summary of the findings with respect to the three research questions.

4.2 Response rate and Normality Test

4.2.1 Response rate

A total of 84 questionnaires were issued, however only 60 were returned which indicates 71% response rate. According to Nachmias and Nachmias (2004) survey researchers face a challenge of low response rate that rarely goes above 50%. Accordingly they suggest that a response rate of 50% and above is satisfactory and presents a good basis for data analysis. Further, Mangione (1995) provided the following classification of response rate: over 85% excellent, 70% - 85% very good and 60%-70% acceptable and below 50% not acceptable. The current study therefore falls under the very good range as it attained 71% response rate.

4.2.2 Normality Test

Table 4.1 provides results of normality tests conducted to establish the normal distribution of the data. As seen in table 4.1, a Kolmogorov statistic showed no significance an indication that the data showed normal distribution.

Table 4.1: Tests of Normality

	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Working capitalmanagement	.143	23	.200*	.943	23	.210

*. This is a lower bound of the true significance.

a. Lilliefors Significance Correction

4.3 Background Information

This section presents the background information with regards to the respondents' age, gender, and level of education. These aspects were put into consideration because of the meaningful contribution they offer to the study.

4.3.1 Nature of the Business

Table 4.3 presents a summary of the findings with regards to the nature of the business. As seen in table 4.3, it is evident that majority of the respondents were sole proprietors (70.0 percent), followed by 16.7 percent who were in partnership, 3.3 percent were co-operatives and finally 10.0 percent were limited liability companies. It is expected that majority of the sole proprietors are not very keen on maintaining financial records, however it will be of interest to establish this in relation to working capital management.

Table 4.2: Nature of the Business

Nature of the Business	Frequency	Percent
Sole Proprietorship	42	70.0
Partnership	10	16.7
Co-operative	2	3.3
Limited Liability	6	10.0
Total	60	100.0

4.3.2 Location of the Business

Table 4.3 presents a summary of the findings with regards to the business location of the various SMEs involved in the study. As seen in table 4.4, it is evident that majority of the respondent SMEs, were located in suburbs (40.0 percent), followed by those in the CBD (36.7 percent and finally open market (23.3 percent).

Table 4.3: Location of the Business

Location of the Business	Frequency	Percent
CBD	22	36.7
Suburb	24	40.0
Open Market	14	23.3
Total	60	100.0

4.3.3 Sex

Table 4.4, shows that there was equity in terms of the respondents sex, in that 50 percent were male while 50 percent were females, an indication that indeed there exists gender parity in the SME sector, meaning that women have not been left behind in the quest for entrepreneurship.

Table 4.5: Sex

Sex	Frequency	Percent
Male	30	50.0
Female	30	50.0
Total	60	100.0

4.3.4 Marital Status

As seen in table 4.6, 33.3 percent of the respondents were indeed married, while 30 percent were single as 16.7 percent were divorced and 20.0 percent widowed.

Table 4.5: Marital Status

Marital Status	Frequency	Percent
married	20	33.3
Single	18	30.0
Divorce	10	16.7
Widow	12	20.0
Total	60	100.0

4.3.5 Level of Education

Table 4.6 revealed that majority of the respondents (30.0 percent) had primary education, followed by 23.3 percent who had secondary education and university education respectively. Additionally 10.0 percent went to polytechnics. It is expected that majority of the SMEs do not necessarily require formal education thus the low levels of education of the respondents.

Table 4.7: Level of Education

Level of Education	Frequency	Percent
Primary	18	30.0
Middle School	8	13.3
Secondary	14	23.3
Polytechnic	6	10.0
University	14	23.3
Total	60	100.0

4.3.6 Financial Records

The study further sought to establish the existence of financial records in the SMEs involved in the study. Table 4.7 indicates that contrary to the expectation majority of the respondents (90 percent), had financial records, while the remaining 10 percent did not have such records.

Table 4.7: Financial Records

Financial Records	Frequency	Percent
Yes	54	90.0
No	6	10.0
Total	60	100.0

The research further sought to examine the types of records kept by the respective SMEs involved in the study. As expected, majority of the respondents (70 percent), only had

sales day books, while 16.7 percent had purchase day books and finally 2 percent had general ledgers while 6 percent had cash books.

Table 4.8: Financial Records

Financial Records	Frequency	Percent
Sales day Book	42	70.0
Purchase Day Book	10	16.7
General Ledger	2	3.3
Cash Book	6	10.0
Total	60	100.0

4.3 Management of Accounts Receivable and Working Capital Management Practice

The study sought to examine the extent to which the management of accounts receivable affects working capital management practice in small and medium enterprises in Nairobi. The following subsection presents a detailed analysis of the findings with regards to how management of accounts receivables affects the working capital management practice.

4.3.1 Source of Raw Materials

Respondents were asked to state the source of the raw materials for their business. As seen in table 4.9, it is evident that majority of the respondents (73.3 percent), get their raw materials locally, while 7 percent get them locally as the remaining 16.7 percent source for raw materials both locally and internationally. This is an indication that indeed SMEs in Kenya do not heavily rely on foreign raw materials for their products.

Table 4.9: Source of Raw Materials

Source of Raw Materials	Frequency	Percent
Local	44	73.3
Foreign	7	7.0
Both	10	16.7
Total	50	96.7
Total	60	100.0

4.3.2 Large Pile Up of Raw Materials

Respondents were asked to state if indeed they experience large pile of raw materials in their business. Table 4.10, shows that majority of the SMEs involved in the study (70.0 percent) experience large pile up of raw materials in their business. This is an indication that indeed SMEs lack requisite inventory management tools that could be essential in the reduction of pile up of raw materials.

Table 4.11: Large Pile Up of Raw Materials

Large Pile Up of Raw Materials	Frequency	Percent
Yes	42	70.0
No	18	30.0
Total	58	96.7
Total	60	100.0

4.3.3 Records of Goods or Materials

Respondents were further asked to state if they do have records of goods or materials in their business. Table 4.11 shows that 76.7 percent agree, that indeed they keep records of goods and materials. It will be of interest to establish if indeed SMEs do stock taking as well as the frequency of stock taking by SMEs in Kenya.

Table 4.11: Records of Goods or Materials

Records of Goods or Materials	Frequency	Percent
Yes	46	76.7
No	14	23.3
Total	60	100.0

4.3.4 Stock Taking

Table 4.12 shows that indeed majority of the respondents (86.7 percent), do carry out stock taking except for 13.20 percent of the respondents who do not take stock.

Table 4.12: Stock Taking

Stock Taking	Frequency	Percent
Yes	52	86.7
No	8	13.20
Total	60	100.0

Table 4.13, further presents the frequency with which respondents were carrying out stock taking. As seen in the table 70 percent of the respondents carry out stock taking daily followed by 16.7 who carry out stock taking monthly and finally 13.3 percent do it yearly. This is an indication that indeed stock taking in SMEs is carried out very regularly given the nature of the business undertaken.

Table 4.13: Frequency of Stock Taking

Frequency of Stock Taking	Frequency	Percent
Daily	42	70.0
Monthly	10	16.7
Yearly	8	13.3
Total	60	100.0

4.3.5 Inventory Management and Working Capital Management Practice

In order to establish the extent to which management of accounts receivable affect working capital management practice in small and medium enterprises in Nairobi a regression analysis was done. As seen in model summary below the R square value is .251 indicating that 25 % of the working capital management practice is influence by inventory management. The Anova results in table 4.17 show that there is no significant relationship between receivable affect working capital management practice in small and medium enterprises in Nairobi.

Table 4.15: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.501 ^a	.251	.215	5.36809

a. Predictors: (Constant), Inventory MGT

Table 4.16: ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	202.596	1	202.596	7.031	.015 ^b
	Residual	605.143	21	28.816		
	Total	807.739	22			

a. Dependent Variable: Working capital management

b. Predictors: (Constant), Inventory MGT

Table 4.17: Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	23.309	5.107		4.564	.000
	InventoryMGT	1.468	.554	.501	2.652	.015

a. Dependent Variable: Working capital management

4.4 Accounts Payable and Working Capital Management Practice

The study also sought to establish the extent to which the management of accounts payable affects working capital management in small and medium enterprises in Nairobi. This subsection will provide a detailed presentation of the findings on how accounts payable management influences working capital management practice.

4.4.1 Credit Purchase

Table 4.18 revealed that majority of the respondents (93.3 percent), were in agreement that they sometimes purchase goods on credit. This is an indication that credit purchase has been adopted largely in the SME sector.

Table 4.18: Credit Purchase

Credit Purchase	Frequency	Percent
Yes	56	93.3
No	4	6.7
Total	60	100.0

The study further sought to establish the purchase period allowed for SMEs in Kenya. As presented in table 4.20, it is evident that most (63.3) percent SMEs are allowed 7 days credit period, 3.3 percent 14 days, 30 percent 21 days, while 2.0 percent are given other credit periods.

Table 4.19: Credit Period

Credit Period	Frequency	Percent
7 Days	38	63.3
14 Days	2	3.3
21 days	18	30.0
Other	2	3.3
Total	60	100.0

In addition table 4.20 present findings with regards to the responses on how the SMEs negotiate with creditors. A substantial majority (80 percent) agreed that they indeed negotiate with creditors to the extent of the credit period.

Table 4.20: Negotiation with creditors

Negotiation with Creditors	Frequency	Percent
Yes	48	80.0
No	12	20.0
Total	60	100.0

4.4.2 Accounts Payable Management and Working Management Practice

The study revealed that indeed there exists a positive significant relationship accounts payable management and working management practice (beta 2.733). The model summary shows an R square value of 0.655, indicating that 66.5 percent of the accounts management practice is influenced by accounts payable management.

Table 4.21 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.809 ^a	.655	.639	3.64222

a. Predictors: (Constant), Payables

Table 4.22 ANOVA^a

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	529.158	1	529.158	39.889	.000 ^b
1 Residual	278.582	21	13.266		
Total	807.739	22			

a. Dependent Variable: Working capital management

b. Predictors: (Constant), Payables

Table 4.22 Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	18.226	2.995		6.086	.000
Payables	2.733	.433	.809	6.316	.000

a. Dependent Variable: Working capital management

As seen in the table 4.22 above there exists a positive significant relationship between accounts payable management and working capital management (2.733). This implies that effective management of accounting payables is likely to enhance working capital among SMEs.

4.5 Cash Conversion Cycle and Working Capital Management

Finally the study sought to examine how cash conversion cycle-affect working capital management in small and medium enterprises in Nairobi. These findings are presented in the following subsection.

4.5.1 Source of Finance

Respondents' source of financing is presented in table 4.23 where 63.3 percent of the respondents borrowed money from the bank, 26.7 percent borrowed from friends, 3.3 percent self-financed their business as the remaining 6.7 percent purchased on credit. This implies that indeed banks have been very instrumental in supporting SME startups.

Table 4.23: Source of Financing

Source of Financing	Frequency	Percent
Borrowing from bank	38	63.3
Borrowing from Friends	16	26.7
Self Financing	2	3.3
Purchasing on Credit	4	6.7
Total	60	100.0

4.5.2 Cash Target

As seen in table 4.24, 80 percent of the respondents agreed of having cash targets for their business while the remaining 20 percent did not have such cash targets. This is an indication of how well SMEs are becoming aware of the nature of working capital management.

Table 4.24: Cash Target

Cash Target	Frequency	Percent
Yes	48	80.0
No	12	20.0
Total	60	100.0

4.5.3 Proceeds Control

Table 4.25 reveals that 60 percent of the respondents save their money in the office till, 30 percent save their money in the bank while the remaining 10 percent spend their proceeds. It is expected that most SMEs do not have a lot of cash proceeds and therefore they would prefer simply saving their proceeds in the office.

Table 4.25: Proceeds Control

Proceeds Control	Frequency	Percent
Office Cash Till	36	60.0
Bank	18	30.0
Spend the Proceeds	6	10.0
Total	60	100.0

The study further sought respondents' views on how they spend their proceeds. As seen in table 4.27, 93.3 percent of the respondents spend within their budget while 6.7 do not spend cash within their budget. Additionally 70 percent record their cash transactions while 30.0 percent do not.

Table 4.26: Cash Expenditure

Statement	Yes	No
Spending within Budget	93.3	6.7
Recording Cash Transaction	70.0	30.0

4.5.4 Cash Conversion Cycle and Working Capital Management

Regression results show a positive significant relationship between cash conversion cycle and working capital management (beta (1.457)). This therefore implies that indeed cash conversion cycle affects working capital management practice among SMEs.

Table 4.27: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	596.791	1	596.791	59.411	.000 ^b
	Residual	210.948	21	10.045		
	Total	807.739	22			

a. Dependent Variable: Working capital management

b. Predictors: (Constant), Cash Conversion cycle

Table 4.28: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	18.969	2.371		8.000	.000
	Cash Conversion cycle	1.457	.189	.860	7.708	.000

a. Dependent Variable: Working capital management

As seen in the table 4.28 above there exists a positive significant relationship between accounts payable management and working capital management (2.733). This implies

that effective management of accounting payables is likely to enhance working capital among SMEs.

4.6 Chapter Summary

In this chapter, results and findings based on the research questions have been presented in form of pie charts, tables and figures as well as graphs. Chapter five provides a detailed discussion of the results and findings. The following section provides conclusions as well as recommendations. Thereafter recommendations for improvement on each specific objective will be provided followed by recommendations for further studies.

CHAPTER FIVE

5.0 SUMMARY, DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter is made up of four sections namely summary, discussion, conclusion, and recommendations in that order. The first section provides a summary of the study, while section two presents a discussion of the major findings of the study. The third Section provides conclusion based on the research questions, and finally the last sub-section provides the recommendations divided into two namely recommendations for improvement and recommendations for further study.

5.2 Summary

The purpose of the study was to examine factors affecting working capital management practice among SMEs in Nairobi. The study was guided by three research questions: To what extent does management of accounts receivable affect working capital management practice in small and medium enterprises in Nairobi? To what extent does the management of accounts payable affect working capital management in small and medium enterprises in Nairobi? How does the cash conversion cycle affect working capital management in small and medium enterprises in Nairobi?

The total population for this study comprised of 424 registered SMEs in Nairobi, out of which a sample of 84 SMEs was taken representing 20 percent of the target population. The population comprised of only those SMEs who were registered at the time that the study was carried out. The study adopted a descriptive research design. This design was appropriate for this study because it necessitated collection, organization and summarizing data from a sample for conclusions. The data analysis involved frequencies and regression analysis. The data was presented by bar graphs, pie charts and frequency indeed and regression tables.

The study revealed that accounts receivable management affect working capital management practice in small and medium enterprises in Nairobi. It was evident that majority of the respondents (73.3 percent), get their raw materials locally, while it

was also revealed that SMEs lack requisite inventory management tools that could be essential in the reduction of pile up of raw materials. In the same regard 76.7 percent agreed, that indeed they keep records of goods and materials and finally majority for the SMEs were seen to carry out stock taking daily. Regression results also showed a positive relationship between accounts receivables and working capital management practice in SMEs.

The study further revealed that accounts payable management affect working capital management in small and medium enterprises in Nairobi. Additionally the study revealed that credit purchase has been adopted largely in the SME sector. Respondents also agreed that they are allowed a credit period that range from 7 days to more than 21 days. Similarly respondents agreed that they indeed negotiate with debtors to the extent of the credit period. A regression analysis showed a positive significant relationship between accounts payable management and working capital management.

Finally it was revealed that cash conversion cycle management affect working capital management in small and medium enterprises in Nairobi. Additionally majority of the SMEs were seen to have received their finances from banks, friends and self-financing respectively. In the same regard, it was revealed that SMEs have cash targets though most of them simply keep their cash in cash tills, while a few others spend their proceeds.

5.3 Discussion

5.3.1 Accounts Receivable and Working Capital Management

The study revealed that accounts receivable management affect working capital management practice in small and medium enterprises in Nairobi. It was evident that majority of the respondents (73.3 percent), get their raw materials locally, while it was also revealed that SMEs lack requisite inventory management tools that could be essential in the reduction of pile up of raw materials. In the same regard 76.7 percent agreed, that indeed they keep records of goods and materials and finally majority for the SMEs were seen to carry out stock taking daily. Regression results also showed a

positive relationship between accounts receivables and working capital management practice in SMEs

The study findings agree with a study carried out by Bowen and Mureithi in 2009 on management of business challenges among small and Micro Enterprises in Nairobi revealed that debt collection ranks among the top three challenges small and micro enterprise owner operating in Nairobi face in their businesses (Bowen & Mureithi, 2009). Trade receivables are frequently classified as accounts receivable, and note receivables. Non trade receivables are receivables that do not result from the core business of the small enterprise (Sunday, 2011).

Similarly the findings showed that in order to help maintain a steady cash flow and deal effectively with business credit, accounts receivable should be recorded and paid when due. To ensure that receivables are not overstated on the balance sheet, which has negative tax implications; best practice requires that receivables are stated at their net realizable value by reducing its amount receivable by the amount it estimates it will not collect either by using percentage of sales on its income statement or by using the aging of the account receivable on the balance sheet (Sunday, 2011).

In the same regard, the study established that trade receivables arise from a variety of transactions and can be written promises either to pay or deliver. Some examples of non-trade receivables are: interest receivable, loans to officers, advances to employees, deposit to cover potential damages or loss, deposit as a guarantee of performance or payment, dividends receivables, claims against insurance companies, government bodies for tax refunds, creditors for returned, damaged or lost goods, customers for returnable items such as crates or containers, etc. Because of the peculiar nature of non-trade receivables, they are generally classified and reported as separate items in the balance sheet (Nazir, 2008).

Finally the research findings are an affirmation of how it is essential to handle accounts receivables effectively, SME investors will need to consider the following factors when setting up their account receivable process: Properly maintaining customer details and credit information; appropriate credit terms and billing cycle – faster you bill, the faster you get paid; providing small discounts to encourage early payment; developing and

maintaining age receivable schedules, regularly review age receivables and monthly customer statements and implement policies to ensure timely and efficient collection of outstanding accounts, such as making follow up phone calls or setting reminders (Connolly, 2013).

5.3.2 Accounts Payable Management and Working Capital Management Practice

The study further revealed that accounts payable management affect working capital management in small and medium enterprises in Nairobi. Additionally the study revealed that credit purchase has been adopted largely in the SME sector. Respondents also agreed that they are allowed a credit period that range from 7 days to more than 21 days. Similarly respondents agreed that they indeed negotiate with debtors to the extent of the credit period. A regression analysis showed a positive significant relationship between accounts payable management and working capital management.

The study findings agree with a research carried out by Kehinde in 2011 on effective working capital management in small and medium scale enterprises which revealed that most SME suffer from the problem of paying all bills/cash outflow from cash earnings which most of the time. He maintains that for most SME's the production and sales cycle is shorter than the average age of accounts payable, creating a scenario where trade debt builds up in an ever increasing manner until a point where the SME cannot pay debts in due date, and eventually collapses (Kehinde, 2011).

In the same regard, the study findings are an affirmation of management of payables is an important factor in an SME's working capital management, and a key indicator of overall operational effectiveness. If it's too high, the SME may soon have trouble paying bills on time, leading to costly penalties; if it's too low, the SME could unwisely be paying bills early, rather than enjoying the full grace period and investing any surplus cash into the business. In managing payables, timeliness and accuracy are critical. They create continuity and consistency, and builds trust with your vendors and stakeholders, while enabling your organization to function properly (Tagoe, 2008).

Additionally the findings align with JICA (2008), who affirmed that just as accounts receivable ratios can be used to judge a company's incoming cash situation, the account payable ratio can be used to demonstrate how a business handles its outgoing payments. A high ratio means there is a relatively short time between purchase of goods and services and payment for them, and a lower accounts payable turnover ratio usually signifies that a company is slow in paying its suppliers (JICA, 2008). It also follows that SME's unpaid bills can have a big impact on its profitability. They can either improve the SME's profitability or they can cause it to really take a hit. Two primary ways that accounts payable affect SME's profitability are the SME's relationships with its suppliers or vendors and the company's cash flow (Khan, 2007).

Finally the study showed how SMEs are creating relations with their debtors. This is indeed an indication that good supplier relationships provide a win-win situation for the company and the supplier. Suppliers will cut good deals for the company. They will suggest new and better products to the company. They will work with the company on delivery times and policies. Good supplier relationships mean increased company efficiency. If the SME pays its bills on time, actively cultivates good relationships with its suppliers, doesn't cut off suppliers with no reason, and keeps lines of communication open, a good supplier should then offer the SME the best trade credit terms possible and good trade credit terms will maximize the SME's profitability (Chandra, 2008).

5.3.3 Cash Management Cycle and Working Capital Management Practice

Finally it was revealed that cash conversion cycle management affect working capital management in small and medium enterprises in Nairobi. Additionally majority of the SMEs were seen to have gotten their finances from banks, friends and self-financing respectively. In the same regard, it was revealed that SMEs have cash targets though most of them simply keep their cash in cash tills, while a few others spend their proceeds. The findings are in line with a study by Abel (2008) who in his research on the impact of working capital management on cash holding of small and medium enterprises in Sweden, he discovered that efficient working capital management is positively related to levels of cash holdings. The cash conversion cycle is the number of days negotiated financing is needed to support the operating cycle of a business. A business's operating

cycle is simply the number of days its goods are tied up in inventory plus the number of days its sales are tied up in receivables. The cash conversion cycle then is a measure of how efficiently accompany operates. But more importantly, it is ensure of cash creation efficiency in the business (Ternel, 2007).

Additionally the study findings are in agreement with a study by Appuhani (2008) who established a traditional link between the cash conversion cycle and the firm's profitability is that shortening the cash conversion cycle increases firm's profitability. On the other hand shortening the cash conversion cycle could harm the firm's operations and reduces profitability. This could happen when taking actions to reduce the inventory conversion period, a firm could face inventory shortages; when reducing the receivable collection period a firm could lose its good credit customers; and when lengthening the payable deferral period a firm could harm its own credit reputation.

The study findings however contradict the argument by Arbor (2010), on how identifying optimal levels of inventory, receivables, and payables where total holding and opportunities cost are minimized and recalculating the cash conversion cycle according to these optimal points provides more complete and accurate insights into the efficiency of working capital management. In this regard, we suggest an optimal cash conversion cycle as more accurate and comprehensive measure of working capital management (Arbor, 2010). Peterson (2012) however maintains that the main point to remember, however, is that an understanding of each of the three factors in the formula can help pinpoint the trend not only in the cash conversion cycle but also in the individual processing periods themselves, insights that can give both a synopsis of operational efficiency and the justification behind it.

5.4 Conclusion

5.4.1 Accounts Receivable and Working Capital Management Practice

The study concludes that accounts receivable management affect working capital management practice in small and medium enterprises in Nairobi. It evident that SMEs in Kenya, get their raw materials locally, however they still face the challenge of

lacking requisite inventory management tools that could be essential in the reduction of pile up of raw materials. In the same regard it can be concluded that SMEs in Nairobi keep records of goods and materials and also carry stock taking frequently.

5.4.2 Accounts Payable and Working Capital Management Practice

The study concludes that accounts payable management affect working capital management in small and medium enterprises in Nairobi. Additionally the study concludes that credit purchase has been adopted largely in the SME sector with SMEs allowed a credit period that range from 7 days to more than 21 days. Similarly SMEs were seen to indeed negotiate with debtors to the extent of the credit period, an indication of how good there exists a relationship between these parties.

5.4.3 Cash Management Cycle and Working Capital Management Practice

Finally the study concludes that cash conversion cycle management affect working capital management in small and medium enterprises in Nairobi. Additionally majority of the SMEs were seen to have gotten their finances from banks, friends and self-financing respectively. In the same regard, it was concluded that SMEs have cash targets though most of them simply keep their cash in cash tills, while a few others spend their proceeds.

5.5 Recommendations

5.5.1 Recommendations for Improvement

5.5.1.1 Accounts Receivable and Working Capital Management Practice

The study recommends that SMEs need to be cautious about their accounts receivables position given that if this is not properly managed, there is likelihood that it will dwindle their performance. In this regard therefore the study recommends that SMEs need to balance between credit sales and cash sales so as to avoid running into a put into cash strap position.

5.5.1.2 Accounts Payable and Working Capital Management Practice

The study acknowledges the important role played by accounts payable in working capital management practice and as such the study recommends the need for SMEs to put in place tools to effectively manage accounts payables so as to enhance the efficiency off the business process and to avoid the challenges that are likely to emanate from overreliance on debts.

5.5.1.3 Cash Management Cycle and Working Capital Management Practice

Cash management has been established to be critical in working capital management practice. In this regard therefore the study recommends that SMEs should adopt the culture of standard liquidity position so as to reduce the risk of losses as a result of too much cash at the business place which might dent the performance of SMEs.

5.5.2 Recommendations for Further Studies

The main limitations of the study were none other than limited time measurement for the collection of data as well as the questionnaire survey. The researcher therefore recommends that since the SME sector is still likely to experience growth, there is need to enhance creativity and innovation as a tool of not only facilitating competitive advantage and profitability but also streamlining the sector to suit into the millennium development goals. In this regard therefore the researcher recommends that there is need to have additional studies conducted in this area as it was superficially discussed in this paper.

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APPENDIX I: QUESTIONNAIRE

INTRODUCTION

United States International University

School of Business Administration

P.O. Box

Nairobi

May 1st 2014

Dear entrepreneur,

I am a Master's of Business Administration student at the United States International University. I am conducting a research study to examine "factors affecting working capital management practices in Small and medium enterprises in Nairobi district. You have been selected to take part in this study. I would be grateful if you would assist me by responding to all items in the attached questionnaire.

Your name does not need to appear anywhere in the questionnaire and the information will be kept confidential and will be used for the academic research purpose only.

Your cooperation is greatly appreciated and I thank you in advance.

Yours sincerely,

Jean Paul

Mobile number 0727 801 475

SECTION A: GENERAL INFORMATION

1) What is the nature of the enterprise?

Sole proprietorship Partnership c. Co-operative d. Limited liability other (please specify).....

2) Where is the enterprise located?

a. Down town CBD b. Suburb c. Open market d. Rural
e. Other (please specify).....

3) Age of the respondent (Years) Please specify.....

4) Sex of the respondent

a. Male b. Female

5) Marital status

a. Married b. Single c. Divorce d. Widow

6) What is your highest level of Education?

a. Primary b. Middle school c. Secondary d. Polytechnic
e. University
f. Other (please specify).....

7) What is the current workforce.....

8) Does the business keep financial records of the operations?

a. Yes b. No

9) If yes to question 8, what kind of records are kept?

- a. Sales daybook
- b. Purchases daybook
- c. General Journal
- d. Cash Book

SECTION B: LIQUIDITY (CASH) MANAGEMENT

13) How did you finance your business initially?

- a. By borrowing from Bank b. By borrowing from friends c. Self-financing
d. Purchasing on credit

14) Do you normally get cash target in advance for your business?

- a. Yes b. No

15) How do you manage the difference in our required cash where there is shortage?
.....

16) Do you write down such estimates of cash requirement as a plan or budgeted document?

- a. Yes No

17) 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.....

18) Do you spend within your budget? a. Yes b. No

19) Do you normally record all cash transactions?

- a. Yes b. No

20) How often do you send money to the bank?

- a. Daily b. Weekly c. Monthly d. Other (please specify)

21) 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 (pleasespecify).....

SECTIONC: ACCOUNTS RECEIVABLES

22) Do you sometimes sell on credit?

- a. Yes []
- b. No []

23) If yes to question 22, 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. Other (please specify).....

24) If no to question 22, then give reasons.....

25) Do you undertake formal credit investigation before granting credit to your customers?

- a. Yes []
- b. No []

26) 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	<input type="checkbox"/> []	<input type="checkbox"/> []
b. Check customers past financial dealing with the company	<input type="checkbox"/> []	<input type="checkbox"/> []
c. check customers bank reference	<input type="checkbox"/> []	<input type="checkbox"/> []
d. Other measures	<input type="checkbox"/> []	<input type="checkbox"/> []

27) What evidence exists for a customer indebtedness?

- a. Signing of delivery note or other receipts document []
- b. Signing of formal IOU document []
- c. Other (pleaseSpecify).....

SECTIOND: MANAGEMENTOF INVENTORY

31) What are the sources of your raw materials?

a. Local b. Foreign c. Both

32) Do you often experience a large pile-up of raw materials?

a. Yes

b. No

33) Do you keep records of your goods or materials?

a. Yes

b. No

34) Do you do regular stock taking?

a. Yes

b. No

35) If yes in question 34, how often do you do it?

a. Daily b. Monthly yearly

d. Other (pleasespecify).....

36) Do you have are-order level policy for requesting stock or materials?

a. yes

b. no

SECTION E: CURRENT LIABILITIES

37) Do you sometimes purchase goods on credit?

a. Yes []

b. No []

38) If yes to question 37 above, how many days or period are you given by your creditors to settle the bills?

a. 7 days [] b. 14 days [] c. 21 days [] d. Other (please specify).....

39) If no to question 38 above, how does that affect your operation?

.....

40) Do you negotiate with your creditors to extend the credit period?

a. Yes [] b. No []

41) Do you use short-term funds of the business for long-term investment?

a. Yes []

b. No []

42) Which of the following four components of working capital do you give preference?

a. Cash

b. Debtors

c. Stock

d. Creditors