

# Working Capital Management and Financial Performance of Small and Medium-Sized Enterprises (SMEs) and SACCOS in Kenya

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## Abstract:

Small and medium-sized enterprises (SMEs) play a critical role in driving economic growth, creating employment opportunities and promoting local revenue generation in Kenya. However, they face various challenges such as limited financial resources, inadequate infrastructure and volatile market conditions. Effective working capital management (WCM) is essential for SMEs to overcome these obstacles and achieve sustainable success. The aim of this research is to examine the impact of WCM on the financial performance of SMEs in Kenya. This paper uses literature review methodology to draw conclusions. The literature review provides insights from various studies that highlight the importance of credit management and internal factors that influence organizational performance. An efficient WCM is crucial for ensuring the financial stability of companies, especially SMEs. Poor WCM can lead to financial challenges and possible bankruptcy, while effective management can significantly increase financial efficiency. WCM involves monitoring a company's current assets and liabilities to ensure timely commitments while minimizing associated costs. This research contributes to understanding the importance of WCM for SMEs in Kenya and provides stakeholders with practical insights to improve financial performance through effective WCM strategies tailored to the Kenyan context.

**Keywords:** Working Capital Management, Credit Management, Financial performance, SACCOS, SMEs

## 1. Introduction

SMEs play a crucial role in stimulating economic growth, creating employment opportunities and promoting local revenue generation. Despite their importance, SMEs

in Kenya face several obstacles such as: B. limited financial resources, inadequate infrastructure and unstable market conditions. Effective working capital management is critical for SMEs to overcome these challenges and achieve sustained success. The main objective of this research is to examine the impact of working capital management on financial performance of small and medium enterprises in Kenya. In particular, the research aims to assess the existing strategies used by SMEs in this area to manage their working capital, analyze the relationship between WCM and key financial performance indicators such as operational efficiency, solvency and profitability, and SME owners and policy makers to provide practical recommendations and financial institutions to improve strategies for dealing with short-term assets and liabilities to improve the financial performance of SMEs in Kenya.

To achieve these objectives, the study will examine the following questions: What are the main working capital management approaches used by SMEs in Kenya? How does WCM impact the financial results of small and medium-sized businesses in the region? What steps can SMEs in Kenya take to increase their competitive advantage and financial sustainability through better working capital management practices? Efficient management of working capital is crucial to ensuring the financial stability of companies, especially SMEs. Poor working capital management can lead to financial difficulties and potential bankruptcy, while effective management can significantly improve financial efficiency. Working capital management involves monitoring a company's current assets and liabilities. These assets typically include cash reserves, accounts receivable and inventories, while liabilities consist of obligations such as accounts payable and short-term debt. The main goal of current asset management is to ensure that a company has enough current assets to meet its obligations in a timely manner while minimizing the costs associated with managing those assets.

Assessing financial performance is often critical to assessing a company's effectiveness. This assessment typically includes various financial ratios such as Gearing Ratio, Quick Ratio and WCM Ratio, which provide valuable insights into a company's ability to generate profits, maintain solvency and liquidity. Effective management of working capital by SMEs in Kenya has a significant impact on their financial position.

## 2. Literature Review

### 2.1 Working Capital and financial performance

Nyambane (2023) conducted a study with the aim of evaluating the influence of different aspects of fiscal management on fiscal results concerning SACCOs. The findings revealed that the management of outstanding invoices significantly impacts fiscal outcomes, despite the limited effects of cash and unpaid invoices oversight. This highlights the necessity for SACCOs to prioritize enhancing their credit management strategies to improve their overall financial position.

Furthermore, Bhatti's (2023) research scrutinizes various metrics, such as return on assets (ROA), return on equity (ROE), return on the capital employed (ROCE), asset turnover (ATO), and Tobin's Q. Internal factors affecting firm performance, such as agency conflicts, corporate governance mechanisms, strategic business approaches, working capital management strategies, debt management, and firm size, are comprehensively examined. Sogomi et al. (2024) made a striking observation that emerged from this research: the realization that poor working capital management has the potential to bring about the downfall of even the wealthiest companies.

Abdiwadud (2022) conducted a study focusing on investigating the relationship between different financial performance metrics and key operational elements like customer debts, vendor debts, inventory management, and funds management. The results indicated that an increase in accounts receivable led to a proportionate yet statistically insignificant negative impact of 1.5% on financial performance; conversely, a rise in accounts payable showed a significant negative correlation with financial performance.

Mbathi's (2022) findings underscore the importance for SMEs in Makueni to prioritize enhancing their liquidity cycle, inventory holding period, accounts receivable collection period, and accounts payable period to optimize their operational efficiency. Monetary institutions are recommended to provide more comprehensive training to small and medium-scale enterprises on effective working capital management strategies before offering loan facilities. Kiiru's (2020) study revealed a significant negative correlation between the management of receivables, payables, and inventory with profitability.

In Ibrahim U. A.'s (2021) study, the results align with the theoretical framework, indicating that each aspect of working capital management significantly impacts financial performance. Particularly, the study identified that the Inventory Turnover Period (ITP) and Accounts Payable Period (ACP) had an inverse relationship with Earnings Per Share (EPS), while the Accounts Payable Period (APP) showed a positive correlation with EPS. Moreover, all control variables were found to be statistically significant except for the firm's age, which exhibited a positive association with EPS. The research suggests prioritizing the

reduction of ITP and ACP while simultaneously increasing APP to enhance both liquidity and profitability.

Abdiwadud's (2022) study analyzing the correlation between various financial performance metrics indicated that an increase in inventory management displayed an insignificant negative correlation with financial performance. Ibrahim's (2021) study emphasizes the significant impact of the cash conversion cycle and debt collection period on business performance. It argues that a prolonged cash conversion cycle and extended debt collection period are linked to reduced business performance, potentially leading to decreased profitability. Conversely, the study suggests that a longer period for paying creditors is associated with improved business performance, potentially contributing to increased profitability.

The investigation carried out by Musiita (2023) was designed with the primary objective of examining the relationship between various elements of liquidity management and the financial performance of Savings and Credit Cooperative Societies (SACCOs) located in the Bushenyi District. The results of the research highlighted a statistically significant positive correlation between liquidity ratios, liquidity levels, metric proportions, and the financial outcomes of SACCOs. These findings suggest that effective management of liquidity, as indicated by these ratios, is associated with enhanced financial performance. Additionally, the study identified a positive connection between comprehensive liquidity management practices and financial performance, indicating that positive changes in liquidity management strategies can lead to favorable financial results for SACCOs.

In a scholarly inquiry conducted by Ogbodo (2021), the main focus was to elucidate the impact of day-to-day funds management on the financial performance of food and beverage establishments in Nigeria. The findings revealed that while accounts receivable had a positive influence on a company's return on assets, this impact did not reach statistical significance. On the other hand, both accounts payable and inventory were found to have a negative impact on return on assets, with only accounts payable showing statistical significance. The study concluded that efficient management of working capital plays a crucial role in shaping organizational performance and directly affecting profitability.

The study conducted by Makina in 2020 shed light on a positive relationship between inventory management, cash conversion cycles, debt management, and the operational efficiency of small and medium-sized enterprises in the Mombasa Region. The research emphasized the significant role played by these variables in determining the success of small and medium-sized businesses in the area. The results indicated that adopting effective working capital management strategies, such as optimizing inventory

levels, managing cash conversion cycles efficiently, and handling debts skillfully, can have a substantial impact on the overall performance of SMEs in Mombasa County. This insight holds great importance for policymakers, providing valuable guidance for developing strategies aimed at strengthening the business environment for SMEs. According to a study conducted by [Alhassan in 2022](#), proficient management of inventory procurement shows a noteworthy and substantial correlation with financial performance.

A research endeavor led by [Adegbie in 2020](#) explored the influence of inventory management, which includes control over supply acquisition, assurance, and utilization, on the financial performance of conglomerate firms listed in Nigeria. The study highlighted the essential role of inventory management in reducing production costs and improving profitability for these conglomerates. Effective inventory management involves various processes such as forecasting, procurement, transportation, inspection, material handling, storage, warehouse management, supplier relations, and implementation of inventory security measures. [Bhatti's study in 2023](#) reviewed a wide range of theoretical frameworks related to corporate performance, including shareholder theory and stakeholder theory. The study emphasized the balanced scorecard approach, which provides a comprehensive evaluation of performance by integrating financial metrics, customer satisfaction, internal processes, and learning and development initiatives.

Based on the findings of [Mwanza's \(2023\)](#) research, the proficiency demonstrated by supermarkets in managing their working capital depends on the advantages gained from these practices. Conversely, facing challenges indicates inadequate management of working capital. [Alvarez's \(2021\)](#) research study brought to light a significant and meaningful relationship between each component of operational funds and profitability. The findings of the study indicated that by optimizing all parameters under scrutiny, there was an enhancement in performance in terms of both Return on Assets (ROA) and Return on Equity (ROE). On the contrary, the study also pointed out that leverage demonstrated a negative and statistically significant association with profitability. This suggests that an increase in debt had an adverse impact on the performance of firms.

In 2022, [Nguono](#) conducted an investigation with the aim of elucidating the correlation between the management of short-term assets and the financial outcomes of specific small-scale financial institutions holding funds in Kenya. The primary objective was to delve into how effective management of operating capital influences the overall financial position of these institutions. By employing a descriptive research design and quantitative methodologies such as contingency tables and association analysis, the study scrutinized elements including the current asset ratio, liquid asset ratio, and return on assets (ROA).

Kiiru's (2020) study focused on exploring the impact of working capital management on the profitability of flour milling businesses in Kenya. The findings revealed that working capital management had a significant influence on the profitability of these enterprises, explaining a substantial 73.8% variance in their profitability. The study recommended that company leaders develop efficient strategies regarding receivables, payables, and inventory management to shorten evaluation periods and strengthen firm profitability.

### *2.2 Cash Conversion Cycle*

The investigation conducted by Abdiwadud (2022) delved into analyzing the relationship between various financial performance metrics, showing that an improvement in cash management had a positive effect on financial outcomes. Additionally, Kiiru's (2020) research indicated a positive correlation with cash management. In Mbathi's (2022) study, it was revealed that the cash conversion cycle, inventory holding period, and outstanding invoice duration had a positive impact on the profits of small and medium-sized enterprises, while there was a negative correlation between accounts receivable duration and SME profitability. These insights are crucial for government officials and policymakers looking to strengthen the SME sector, which plays a significant role in the nation's economy. It is recommended that the government implement training programs aimed at enhancing the business management skills of SMEs.

Wekesa's (2022) inquiry focused on examining the influence of the cash cycle on the financial performance of manufacturing firms listed on the Nairobi Securities Exchange (NSE). The study found that the Cash Conversion Cycle (CCC) did not have a significant impact on the financial performance of these manufacturing businesses. However, it emphasized the importance of effective management of receivables, inventory, and payables, which positively affected the financial outcomes of production firms listed on the NSE. Wekesa's (2022) suggests that while the Cash Conversion Cycle (CCC) may not directly impact financial performance within this context, proficient management of receivables, inventory, and payables is crucial for enhancing the overall financial performance of manufacturing companies listed on the NSE.

Ngari's (2023) research uncovered a significant negative relationship between the operating cycle (CCC) and profit margin. The findings suggest that a reduction in the CCC could lead to increased profitability through various channels such as improved cash flow, reduced financing costs, and enhanced operational efficiency. The literature review examines in detail the impact of corporate culture on organizational performance and emphasizes its fundamental role in determining the success and long-term profitability of

a company. It highlights the importance of aligning company culture with the overarching company strategy to drive positive performance outcomes. Bhatti's 2023 study is referenced to illustrate the differential impact of organizational culture on organizational performance between organizations in Organization of Islamic Cooperation (OIC) countries and those in non-OIC countries. In OIC countries where corporate culture negatively influences performance, stricter working capital guidelines are recommended. Conversely, in non-OIC countries where corporate culture has a positive impact on performance, more flexible working capital policies are advocated to improve performance.

### 3. Research Methodology

This paper employs the methodology of a literature review to synthesize and extrapolate conclusions based on a comprehensive analysis of existing academic works within the field. Numerous scholarly investigations focusing on the topics of working capital management and its impact on financial performance have been meticulously examined and evaluated to provide a comprehensive understanding of the subject matter.

### 4. Discussion

The importance of credit management is highlighted in Nyambane's study, which focuses on the significant impact that managing outstanding invoices can have on the financial results of SACCOs. This highlights the critical importance of robust credit management strategies for ensuring financial stability and improving overall performance in the context of financial institutions. Bhatti's research conducts an in-depth study of internal factors that takes a comprehensive look at various internal factors that influence business performance, with a special focus on working capital management strategies. This detailed analysis makes it clear that companies must consider a variety of factors and adopt holistic approaches in order to effectively optimize and increase their performance levels.

Abdiwadud's (2022) study of financial performance metrics addresses the complex relationship between financial performance metrics and operational elements such as customer debt and inventory management. This research highlights the critical importance of understanding how different metrics interact with each other and influence an organization's overall performance results. Mbathi's (2023) findings highlight the importance of optimizing liquidity cycle and working capital management strategies for SMEs to increase their operational efficiency. This highlights the importance of

implementing effective working capital management practices to drive improvements in the performance of small and medium-sized businesses.

Ibrahim's study highlights the significant impact that certain components of working capital, such as: B. the inventory turnover period and the accounts payable period, can have an impact on financial performance measures such as earnings per share. This suggests that companies should prioritize optimizing these components to improve both the liquidity and profitability of their operations. [Abdiwadud's \(2022\)](#) Management of Cash Conversion Cycle analysis highlights the positive impact of improved cash management on financial results. Competent understanding and management of the cash conversion cycle can lead to improved financial outcomes for companies and highlights the importance of this aspect in financial management strategies. The discussion of aligning organizational culture with strategy underscores the influence of organizational culture on organizational performance and emphasizes the need to align culture with strategic goals. It is critical for organizations to ensure their culture aligns with and supports their overall performance goals to effectively drive success.

[Ngari's \(2023\)](#) research on continuous improvement of working capital practices suggests that shortening the operating cycle can lead to greater profitability through improved cash flow and operational efficiency. This highlights the critical importance of consistently evaluating and refining working capital management practices to drive positive financial results and sustainable growth. Taken together, these findings highlight the critical role of effective financial management, a comprehensive understanding of performance metrics, and continuous improvement of working capital practices in increasing organizational performance levels and increasing profitability within companies.

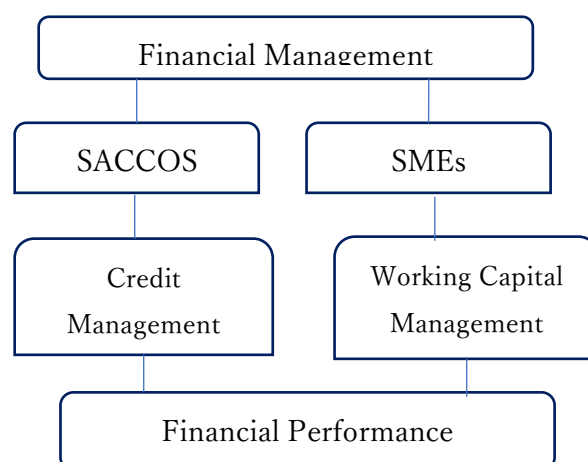


Figure 1: Relationship between WCM& Financial Performance

Figure 1 illustrates a comprehensive framework in which fiscal management assumes a central position in the operational dynamics of both Savings and Credit Cooperatives (SACCOs) and Small and Medium Enterprises (SMEs). The framework underscores the pivotal importance of specific strategic interventions within each sector, notably encompassing credit management and working capital management as fundamental pillars. Moreover, a closer examination of these strategic frameworks reveals the intrinsic significance of key components such as the management of outstanding invoices and inventory control, which are identified as critical determinants shaping the financial outcomes of the respective entities.

## 5. Conclusion

In summary, the cumulative findings from the various studies reviewed shed light on the complex interplay between financial management, operational strategies and financial performance in different organizational environments. Nyambane's research places particular emphasis on the critical role that credit management plays in improving the financial performance of SACCOs. This highlights the importance of prioritizing strategies related to credit management. Additionally, the research conducted by Bhatti presents a thorough and comprehensive analysis of internal determinants that influence company performance, highlighting the need for companies to consider a variety of metrics and adopt holistic methods to improve their performance. [Abdiwadud's \(2022\)](#) study further highlights the importance of understanding the impact of financial performance metrics on critical operational aspects, thereby highlighting the importance of optimizing both accounts receivable and accounts payable to increase overall financial performance.

Furthermore, the findings presented by [Mbathi \(2023\)](#) highlight the importance of small and medium-sized enterprises (SMEs) optimizing their liquidity cycle and working capital management strategies to increase operational efficiency. In addition, Ibrahim's research highlights specific aspects of working capital management that have a significant impact on financial performance, thereby suggesting strategies aimed at increasing liquidity and profitability. The selection of studies reviewed also sheds light on the paramount importance of efficient cash management, inventory control and debt collection practices in shaping corporate performance, thereby highlighting the need for companies to pursue effective working capital management strategies to achieve favorable financial outcomes. Overall, the insights gained from these studies provide invaluable guidance for policy makers, organizational leaders, and financial managers in formulating skillful strategies to strengthen financial performance and promote sustainable expansion. By incorporating and operationalizing the lessons learned from these studies, companies can

deftly navigate the complicated terrain of financial management and position themselves for continued success in their respective industries.

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