

3.1 General Objective

To find out the effect of working capital management on the profitability of non deposit-taking microfinance institutions in Kenya

3.2 Specific Objective

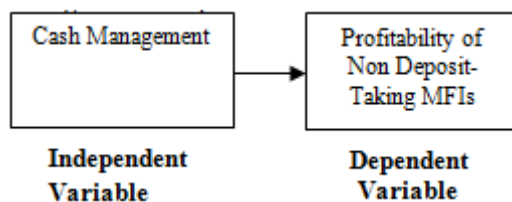
To investigate how cash management influence the profitability of non deposit-taking microfinance institutions in Nakuru East Sub-County

4. Research Question

How does cash management influence the profitability of non deposit-taking microfinance institutions in Nakuru East Sub-County?

5. Conceptual Framework

The conceptual framework (Figure 1) illustrates the interaction between the independent (cash management) and dependent (profitability of non deposit-taking MFIs) variables. The framework hypothesizes that there exists a relationship between cash management and profitability of the afforested MFIs.



6. Literature Review

This section presents a review of theories and empirical studies touching on working capital management (in particular cash management) and profitability of non deposit-taking microfinance institutions.

6.1 Theoretical Literature

6.1.1 Cash Conversion Cycle Theory

It is asserted that the working capital management theory is founded on the traditional models of cash conversion cycle (CCC). It was noted [13] that, it is crucial to understand how fine a firm is organizing its working capital. It is stated that CCC is a dynamic measurement of the time between cash payment for raw materials, and then receiving it from accounts receivable. In the same light, it is posited that relative to the dynamics of ongoing liquidity management, CCC combines both balance sheet and income statement data to measure liquidity with dimension of time.

Indeed, it is deduced that CCC is the most important aspect of working capital management (WCM). CCC illustrate the investment and credit decisions in the customer, inventory and suppliers, which in turn, shows the average number of days from the date when a firm starts payment to its suppliers and date when it begins to receive payments from

its debtors. CCC is employed as the overall measure of working capital since it illustrates the gap between expenditure for purchases and collection of sales [16]. In fact, Jordan defined cash cycle as the time between cash disbursement and cash collection.

Cash cycle can be illustrated in an equation where:

Cash cycle = operating cycle – accounts payable period. On the other hand,

Operating cycle = inventory period + accounts receivable period.

In the context of the current study, the cash conversion cycle can be employed to illustrate the interaction between cash management which is the independent variable of the study and profitability of non deposit-taking MFIs in Kenya.

6.1.2 Walker's Theory

It was observed that this theory postulates that a firm's profitability and growth are partly determined by how its working capital is managed. It is asserted that when the flow of funds created by the movement of the working capital is interrupted, due to diverse reasons, the turnover of the working capital is decreased just as the rate of return on investment. Walker's theory further posits that capital should be invested in each component of working capital as long as the equity position of the organization increases. This is in line with the fact that each shilling invested in either fixed assets or working capital should essentially contribute to the net worth of the firm. More so, it is argued that the type of capital employed to finance the working capital directly affects the amount of risk the organization assumes as well as the opportunity for gain or loss and the cost of capital. Walker's theory enables better comprehension of working capital management. The scholar avers that lenders acknowledge the fact that a firm's ability to repay short-term loans is directly related to cash flow and not earnings. Needless to say, therefore, every firm should ensure that it makes every effort to the maturity of its flow of internally generated funds. Walker's theory can be employed in the current study to explain how non deposit-taking MFIs can manage their cash flows in order to enhance their profitability and eventual growth.

6.2 Empirical Literature Review

This part reviews empirical studies that have hitherto been conducted by different scholars on areas touching on components of non-performing loans and in particular credit risk, and financial performance. The study reviews global, regional, and local studies respectively.

6.2.1 Cash Management

In a study of Belgium's firms, it was noted that, a shorter cash conversion cycle is related to better performance of the enterprises. On the same note, efficient working capital management is pivotal in creation of shareholders' value. In a study carried out in Saudi Arabia, cash conversion cycle (CCC) on a sample of joint stock companies, was established to be of greater importance than current ratio in measuring liquidity that affects profitability [4]. In other words, the former (CCC) has greater effect on the profitability of an enterprise than the latter (current ratio).

A study of a sample of firms listed on New York Stock Exchange, sought to investigate the relationship between CCC and firm's profitability. It was established that there exists a significant relationship between cash conversion cycle and profitability of the firms under study. This was interpreted to imply that indeed management can create value for an enterprise through appropriate handling of CCC. According to the findings of a study on working capital management of manufacturing sector in Pakistan [17] WCM has a significant effect on profitability and plays a crucial role in shareholders' value creation since longer cash conversion cycle has negative effect on profitability of enterprises.

In yet another study [5], it was posited that in developing countries, small enterprises often rely on informal sources of funding and have basic needs, such as managing cash flow through short-term loans and basic savings accounts. A pilot study in South Africa established that most very small firms need a short term line of credit to weather brief (sometimes overnight) cash flow gaps [2]. The study recommended that the MFIs should also need to develop specific training for loan officers. That is, the loan officers should transition from a "character only" lending judgment, as employed by many MFIs in lending decisions, to one that emphasizes on cash flow and collateral or guarantor forms of repayment when making small business lending decisions. A study on MFIs in Ethiopia, revealed that designing product terms tied to client cash flow enhances the repayment capacity and allows the MFIs to sustain their operations.

The study on the relationship between cash flows and earnings performance measures for firms listed in the Nairobi Securities Exchange (NSE) found that there exists a negative relationship between cash flows from financing and investing activities and returns performance indicators. In the same breadth, the effect of working capital management on the performance of 30 firms listed in NSE was studied. It was established that there exists a negative correlation between the time when the cash is collected from customers and the firm's productivity. Interpretatively, more profitable enterprises are bound to take less time to collect cash from their customers contrary to less profitable firms.

In a survey of deposit-taking MFIs in Kenya [12], it was asserted that optimization of working capital balances is interpreted to mean minimizing the working capital requirements and maximizing possible revenues. In other words, it is observed that efficient WCM enhances a firm's free cash flow. This in turn, increases a firm's growth opportunities and return to shareholders. It was posited that the cash flow problems of many small enterprises are aggravated by poor financial management, particularly, the lack of planning requisite cash requirements [7]. It is argued that in Kenya, the current squeeze on cash and credit is threatening the survival of several MFIs both deposit-taking and non deposit-taking. It is further acknowledged that MFIs cannot operate without working capital. In this light, MFIs are recommended to appreciate the fact that WCM is necessary in making short-term decisions in working capital. It should also be ensured that every MFI has the capacity to continue its operations with adequate cash flow for payments of both maturing short-term debt and impending

operation expenses. The study's findings concurred with findings of a previous study [18], that increase in cash conversion cycle is bound to decrease the profitability of a firm.

6.2.1 Concept of Profitability

A dynamic economy and relatively stable macroeconomic and political environment are said to offer an enabling environment to the success of the MFIs. The foregoing dynamism results in increased and growing demand for financial services. In a study of deposit-taking MFIs in Ethiopia, it was argued that, stable macroeconomic conditions and relatively low inflation support the profitability of MFIs. Against this backdrop, macroeconomic stability despite being important is not by itself a sufficient condition for the profitability and growth of MFIs. There exists an interesting scenario. On one hand, it is noted that there are poorly performing MFIs in countries with stable macroeconomic conditions. On the other hand, it is possible for MFIs to operate effectively even when the economy is not that stable.

It is further asserted that regulatory environment affects growth, efficiency, productivity, and sustainability of MFIs. The growth of outreach in MFIs in Ethiopia is noted to have positive implications on financial institutions. Some of the reasons include that, it enables the MFIs to reach large number of clients and attain sound impact on reducing poverty; reduce average operating cost of MFIs by reducing or eliminating losses, and not by increasing lending interest rates; improves financial and operational sustainability; helps MFIs to satisfy their clients' needs through various services; presents a better image of MFIs so as to attract loan capital from banks, donors, and social investors for their expansion; and enhances the borrowers' willingness to repay. It is also asserted that improving access to loan capital and developing efficient and effective systems for mobilizing savings are crucial for enhancing outreach and capitalization of MFIs. Moreover, the profitability and performance of MFIs is posited to mainly depend on their capacity. For this to be achieved there ought to be improvement in governance, human resource development, systems development, technology development, and mobilization of funds.

A study on the problems that affect the growth of MFIs in Tanzania was conducted [11]. It was realized that the most important factors that inhibit the growth of MFIs include the educational levels of customers, lack of capital to lend to clients and staff related incentives, and skills development. In a study of performance of MFIs in Tanzania [8], it was established that commercial banks outperform traditional MFIs. In the same right, balanced scorecard was recommended on the grounds that it provides the potential to investigate the overall performance of MFIs from two dimensions, that is, financial and non-financial performance.

The potential role of MFIs in mobilizing savings; taking the cases of Uganda and Kenya was assessed [6]. The scholar observed that while enterprises require minimal capital to start their businesses, a relatively large amount of capital is required to invest in on-going operations. Moreover, it is posited that some funds are required as a buffer against

declines in profitability. Furthermore, additional capital is necessary to facilitate profitability. Savings accumulation is asserted to present a crucial tool to generate business growth. In a study of deposit taking MFIs in Kenya [12], it was noted that efficient WCM increases an enterprise's free cash flow, which in turn, it was argued, enhances a firm's growth opportunities and return to shareholders.

7. Research Methodology

The current study, in carrying out the investigations, adopted a descriptive survey research design. Descriptive research seeks to find out what is happening, or what is causing a certain happening to occur [9]. Descriptive studies are, moreover, argued to be popular in business research due to their versatility across disciplines. On the other hand, surveys are more often cross-sectional in nature and as such their rationale, as exemplified in this study, was to collect data and carry out a study at a particular point in time and to use it to describe existing conditions.

The target population is asserted to be the population to which the study findings will be generalized. In the current study, the target population comprised of the 63 accounting/finance officers, credit officers, and management staff of the 19 non deposit-taking MFIs within Nakuru East Sub-County. Given that the target population was relatively small (less than 100) census survey was employed [9]. This method was the most suitable since it eliminated the sampling bias because all members of the target population participated in the study. The study exclusively used a structured questionnaire to collect data. The questionnaire captured the demographic information of the respondents. More importantly, it captured questions on two sets of variables, that is, independent and dependent variables. A pilot test was conducted prior to the main study with the object of determining both reliability and validity of the instrument. Reliability was tested using Cronbach alpha coefficient while validity was tested by use of principal axis factoring method. Propositions in every constructs that returned values of alpha and Eigenvalues equal to or greater than 0.7 and 1.00 respectively for deemed both reliable and valid and as such suitable for the main study.

7.1 Data Processing and Analysis

After collecting the data from the field, the questionnaires were grouped and evaluated to ensure their completeness. This was essential since only complete and accurately filled questionnaires were to be considered for the study. This was followed by coding of the raw data by the help of the Statistical Package for Social Sciences (SPSS) tool. Data analysis was conducted using both descriptive and inferential statistics to analyze the findings from the raw data. Descriptive analysis included measures of central tendency (mean), and measures of variability (frequencies, percentages and standard deviations). On the other hand, inferential analysis involved the Pearson's correlation that sought to establish the relationship between cash management and profitability. The findings were presented in form of tables that reflected both descriptive and inferential statistical findings.

7.2 Research Findings

The study recorded a remarkable 91.07 per cent response rate which was deemed highly suitable for the study.

7.2.1 Descriptive Findings

The opinions of the respondents regarding aspects touching on cash management and profitability of non deposit-taking MFIs are outlined in this section.

a) Descriptive Statistical Findings for Cash Management

The study investigated the views of the respondents regarding aspects touching on cash management in MFIs based in Nakuru East Sub-County, Kenya. Table 1 presents the relevant descriptive findings. It was discovered that, respondents agreed that, squeeze on cash and credit is threatening the survival of non deposit-taking MFIs; non deposit-taking MFIs should emphasize on cash flow and collateral/guarantor forms of repayment when making lending decisions; cash conversion cycle (CCC) has greater effect on profitability than current ratio; non deposit-taking MFIs manage cash flow through short term loans and basic savings accounts; there exists a significant relationship between CCC and profitability of non deposit-taking MFIs; every non deposit-taking MFI should have the capacity to continue its operations with adequate cash flow; shorter CCC is related to better performance of non-deposit-taking MFI, and also has positive effect on profitability of non deposit taking MFIs. This is supported by the findings that the aforementioned propositions returned means tending towards 4.00 (agree). However, they were indifferent (Mean \approx 3.00) regarding the propositions that, cash flows from financing and investing activities affect returns performance indicators negatively, and more profitable non deposit-taking MFIs are likely to take less time to collect cash from their customers.

Table 1: Descriptive Results for Credit Risk

	Min	Max	Mean	S.D.
Cash flows from financing and investing activities affect returns performance indicators negatively	2	5	3.24	.988
More profitable non deposit-taking MFIs are likely to take less time to collect cash from their customers	1	5	3.34	1.289
Squeeze on cash and credit is threatening the survival of non deposit-taking MFIs	2	5	4.00	.707
Non deposit-taking MFIs should emphasize on cash flow & collateral/guarantor forms of repayment when making lending decisions	2	5	4.03	.823
CCC has greater effect on profitability than current ratio	2	5	4.15	.732
Non deposit-taking MFIs manage cash flow through short term loans and basic savings accounts	1	5	4.17	.889
There exists a significant r/p between CCC and profitability of non deposit-taking MFIs	2	5	4.24	.739
Every non deposit-taking MFI should have the capacity to continue its operations with adequate cash flow	3	5	4.38	.728

Shorter cash conversion cycle is related to better performance of non-deposit-taking MFI	3	5	4.45	.572
Shorter CCC has positive effect on profitability of non deposit taking MFIs	3	5	4.45	.572

Descriptive Statistical Findings for Profitability

The researcher sought the opinions of the targeted employees of non deposit-taking MFIs in Nakuru East Sub-County. Table 2 outlines the findings. It was revealed that, respondents strongly agreed (Mean ≈ 5.00; S.D. = 0.572) that, cash management influenced profitability of non deposit-taking MFIs in Nakuru East Sub-County.

Table 2: Descriptive Results for Financial Performance

	Min	Max	Mean	S.D.
Cash management affects profitability of non deposit-taking MFIs	3	5	4.55	.572

7.2.2 Relationship between Cash Management and Profitability

This section presents correlational findings in an attempt to illustrate how cash management affects profitability of non deposit-taking MFIs in Nakuru East Sub-County. The results are as shown in Table 3. The findings indicate that, there exists a very strong and positive correlation between cash management and profitability of MFIs ($\rho = 0.815$; $p < 0.01$). The relationship as illustrated by the findings is also statistically significant. The foregoing is interpreted to imply that enhancement of cash management would very likely result in improved profitability of the aforementioned MFIs

Table 3: Relationship between Cash Management and Profitability

		Profitability
Cash Management	Pearson Correlation	.815**
	Sig. (2-tailed)	.000
	N	29

** . Correlation is significant at the 0.01 level (2-tailed).

8. Summary, Conclusions and Recommendations

In this section, a summary of key study findings is outlined. This is followed by drawing conclusions and suggesting recommendations in light of the study objectives

8.1 Summary

The squeeze on cash and credit is threatening the survival of non deposit-taking MFIs. Such MFIs ought to emphasize on cash flow and collateral/guarantor forms of repayment when making lending decisions. It was also established that, cash conversion cycle (CCC) has greater effect on profitability than current ratio which tallied with opinion of an earlier study [4]; non deposit-taking MFIs manage cash flow through short term loans and basic savings accounts; there

exists a significant relationship between CCC and profitability of non deposit-taking MFIs; every non deposit-taking MFI should have the capacity to continue its operations with adequate cash flow; shorter CCC is related to better performance of non-deposit-taking MFI, and also has positive effect on profitability of non deposit taking MFIs. The findings concurred with the assertion that, a shorter cash conversion cycle is related to better performance of the enterprises. The findings indicated that, there exists a very strong, significant and positive correlation between cash management and profitability of MFIs. Therefore, enhancement of cash management would very likely result in improved profitability of the aforementioned MFIs.

It was revealed that, respondents concurred that, cash management influenced profitability of non deposit-taking MFIs in Nakuru East Sub-County. The findings agreed with a previous study’s assertions that, cash management through setting aside some funds as a buffer against declines in profitability is very necessary [6]. Furthermore, the findings concurred with a study on deposit-taking MFIs in Kenya [12] that, efficient working capital enhances free cash flow and ultimately the growth of a firm.

8.2 Conclusions

The study findings led to the conclusion that, cash conversion cycle (CCC) has great effect on profitability; and that every non deposit-taking MFI should have the capacity to continue its operations with adequate cash flow. It was further concluded that, enhancement of cash management would very likely result in improved profitability of the non deposit-taking MFIs

8.3 Recommendations

The study suggests that, non deposit-taking MFIs ought to enhance their cash management by ensuring among others, that the concerned MFI has adequate cash flow. Scholars are further recommended to conduct studies on the implication of working capital management in other financial institutions such as deposit-taking MFIs. It is also, suggested that, it would be essential to carry out a comparative study on how different financial institutions manage their cash flows.

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