Effect of Working Capital Management on the Financial Performance: Evidence of Construction and Allied Sector Firms Listed at Nairobi Securities Exchange.

Titus Mweta*and **Patrick Kipronoh***

***Department of Accounting and Finance. The Technical University of Kenya**

Abstract

The success of any business depends on how financial managers effectively manage working capital components which includes mainly cash, receivables, payables and inventories. It's required for a company to maintain a balance between profitability and liquidity. This study was carried out to determine the effect of working capital management on the financial performance of contruction and allied companies listed at Nairobi Securities Exchange. Explanatory research design was employed in this study. The target population in this study consisted of all construction and allied companies listed at NSE for the period between 1st January 2012 and 31st December 2016. This study used secondary panel data which consisted of time series and cross sections sourced from published annual financial statements on the company's website and NSE hard books. In the analysis correlation analysis, descriptive statistics and multiple regression analysis was used. The findings clearly showed that there is a weak insignificant association among inventory conversion period, receivables collection period, payables payment period, cash conversion cycle, gross working capital, ratio of current assets to total assets, ratio of current liabilities to total liabilities, current ratio using return on assets and return on equity to measure financial performance. However using gross profit margin to measure financial performance, the findings shows that there is a strong positive relationship among independent variables such as inventory conversion period, ratio of current assets to total assets, ratio of current liabilities to total liabilities and gross profit margin.
Keywords: Working Capital Management, Working Capital Components, Firms, Financial Performance, Liquidity, Nairobi Securities Exchange 1. Introduction Efficient working capital management determines the success or the failure a company because it determines the liquidity and profitability balance of business operations. Working capital management is simply concerned with efficient management of current benefit and current obligations which are expected to mature or to be paid within a period of one year or operating cycle whichever is shorter (Kesimli and Gunay, 2011). In business operations day to day decisions are basely primarily on guaranteed cash flows which facilitate proper management of available resources to ensure effective operations and sustainability of business. Business should be managed efficiently and profitably to increase the amount of cash flows (Kesseren, 2006). When company operations grow, it's important for a company to set controls and measures to make comparison between actual figures and projected figures. The financial manager should determine the net working capital by factoring major elements in the working capital cycle which includes inventories, receivables, cash and payables which are mainly defined by time and money. This is supported by management control theory which argues that there is need to

control agents operations and management actions prior to any action been taken (Smith & Bertozzi, 1998). In most companies there is no clear understanding between liquidity and profitability. Most companies have failed to understand liquidity and profitability tradeoffs when striving to maximize shareholders value which has led to the failure in most organizations to analyze the risk- return tradeoff expected after implementing alternative working capital management policies (Gitman, 1984 & Bhaltacharya, 2001). Liquidity is defined as a condition in which business or companies or firms are able to meet short term obligations when they are due with or without challenges.

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