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RESEARCH ARTICLE

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WORKING CAPITAL MANAGEMENT FUNCTION IN RELATION TO PERFORMANCE: A CASE OF SMALL AND MEDIUM ENTERPRISES IN SUMBAWANGA MUNICIPALITY

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ABSTRACT

This study aimed to assess the working capital management function in relation to the performance of SMEs located in Sumbawanga municipality Rukwa Region, Tanzania. It was guided by the Operating Cycle Theory main objective to investigate how the working capital management function is performed in small and medium enterprises, and how it is linked to organizational performance. The study used mixed approach,thusqualitative and quantitative under which convergent parallel design was used. The targeted population is 4000 SMEs. The registered population that fits this study is 100 SMEs. This should be 80, assuming the error margin of 5% (and 95% confidence level) for a population of between 90 and 100. Purposive sampling and simple random sampling were applied. Questionnaires, and Semi-structured interviews were used as data collection instruments. Descriptive statistics and themes were used to analyze data. Likert-scale were used as the tool for data collection, to be analyzed with the Statistical Package for the Social Sciences (SPSS) version 20 software. The findings showed that the Inventory Management Function not well practiced due to inadequate skills on the inventory management hence poor performance; that the SMEsfirms didn’t understand properly the policies that guides credit sales.

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INTRODUCTION

Working Capital (WC) as defined as the organization/ firm’s investment in short term assets such as inventories, account receivable, and cash(Paramasiva and Subramania, 2009). The working capital management function is among the determinant factors of a business success or failure. Its impact in an organization is observable through the influence it causes on the liquidity states of a firm (Weston and Brighan, 2004). According to scholarly literature in organizational performance and management, Working Capital Management practices can affect the business profitability and hence, its performance (Odiambo, 2016; Paramasiva and Subramania, 2009). Poor management of working capital management function (WCM) can lead to liquidity problems resulting to business failure. Accordingly, firms need to ensure that the WC management function is well observed for effective business sustainability. Working Capital Managment practices are related to all aspects of managing current assets and liabilities. It reflects a company’s day-to-day meeting of supplies requirements and short term obligations. According to Egbide (2009) WC is needed for the acquisition of raw materials, compensation of salaries and wages, day-to-day expenses, and servicing of credit obligations. In essence, a company should ensure a balanced WC, meaning that it should have an optimal level of WC managed in such a manner that cash outflow timing is matched to cash inflow. Excessive levels on either side of WC may lead to an organization to have a negative effect on profitability. For instance, having inadequate level of the short term assets may lead to low levels of liquidity. Stock outs may result in a problem related to maintaining smooth operations (Horne and Wachowicz, 2008). The profitability and liquidity are two key and most important features of the business life (Sanger, 2011). Succinctly, CA was those assets that can stay in the business within one accounting period and have short lifespan. Horne and Wachowicz (2008) defined CA as cash and other assets like inventory and account receivable which are probably to be transformed into cash in the regular sequence of the business within one accounting period constituting the normal operating cycle of a business. Similarly, Abel (2008) defines the CL as the present obligations which are expected settlement by an entity within one accounting period. The liabilities of business are to be repaid back within the agreed time to avoid loss of trust for a business. However, the WC plays a major function in the business concern as the heart and body in a human being. A study conducted by Samuel (2015) in Ghana showed that efficient utilization of a company’s current assets and liabilities normally known as (WCM) required serious consideration. Various empirical studies have indicated that an efficient functioning of Working Capital Management improves the operating performance of a business concern and it helps to meet the short term liquidity (Odhiambo, 2016; Nyagweno and Olweny, 2014; Mogaka and Jagongo, 2013).

Statement of the Problem

Working Capital Management and the performance of an organization in terms of profitability are interrelated. Egbide (2009) elaborately links the failure of a large number of organizations to insufficient working capital management function; which is attributable to the inability of the financial management factor to plan and adequately control the operations of WC. Deloof (2003); Finau (2011) and Koperuntheri (2010), among others, expressed the relationship between WCM and the performance of firms. WCM is a skill learnt in formal business studies. Yet, it is not clear to what extent small and medium businesses (SMEs), specifically for those with no capabilities to hire such skilled professionals, afford the balancing of WC. This is an area not exhaustively empirically covered by scholars in organizational effectiveness and quality management. Thus, the researcher identified this gap and deemed it important to contribute to the existing literature through an assessment on working capital management function in relation to performance of an organization and propose potential solutions that would otherwise address this problem particularly in small and medium businesses out in SMEs using Sumbawanga Municipality.

Specific Objectives

The specific objectives of the study were as follows:

i. To determine how inventory management in small and medium enterprises was conducted and its impact on performance.
ii. To assess the policies governing the management of accounts receivable and accounts payable in small and medium enterprises and their impact on performance.

LITERATURE REVIEW

This study was guided by the Operating Cycle Theory. According to scholars in financial management Miller and Orr (1966); Paramasivan and Subramanian (2009) the management of liquidity can be only realized by providing the proper financial position together with the profit or loss statement analysis. Makori (2013) advanced that financial position analysis helps firms to analyze their financial statement for decision-making purposes. Financial statements are used by external stakeholders to enable them comprehend the overall health of a company and also to assess financial performance and value of the organization while internal constituents' use it as a monitoring tool for managing the finances. The use of this theory enabled the researcher to delve into a deep thoughtful of other elements of liquidity of the firms understudy.

Empirical Literature Review

Brealey, Myers & Allen, (2004) reiterated that firms have raw materials and sell finished goods. The period of buying raw materials up to the date of sales is the period of inventory. Inventories are kept for different reasons such as; sales, speculation against sudden emergencies, and for production of other products. Dimitrios, (2008); and Gizwa, (2019) point out that if the firm have too much inventory demands it requires adequate physical space which could lead to cost associated with keeping inventory, and increase the risk of inventory damages, corrosion and losses. Additionally, large amount of inventory regularly signposts wasteful and uncaring management, inefficient strategic and time, and less attention for progression and procedure. However, large stock of any form of inventory may cause unseen costs and expenses. Therefore, a company should have proper management of inventory to avoid all those costs and unnecessary expenses. Atrill (2006) in his study argued that inadequate financial skills within firms brings problems in stock management in a proficient manner. As firms struggle to achieve efficiency, they should be able to understand their reorder level which enables them to know when inventories are to be ordered and when they should not be ordered. Managing inventory in an explosive business situation is rather problematic than challenging. Many companies' confronts different arrays of problems related to inventory management. It is virtuous for a firm to have suitable strategies concerning inventories that belong to the business (Paramasiva and Subramania, 2009). Otherwise, the business will face a challenge of shortage of cash when it is required and hence, adverse in performance of the firm.

Therefore, management of inventory needs to be carried out with extreme commitment taking into account proper procurement practices (Sitienei and Membe, 2015). Many industries in other countries adopt Economic Order Quantity (EOQ). Bachetti, Plebani, Saccani, and Synthetos, (2010) argued that inventory management requires to be planned in a reasonable means so that SMEs can be able to know when to order and how much to order. Moreover this can only be achieved through the EOQ. The economic order quantity allows SMEs to design their inventory top up on a timely basis such as monthly, quarterly, semi-annually or year basis (Kaled and Hayam, 2016). According to the study conducted by Samiloglue and Demirnes (2008) was founded whether profitability and efficiency WCM of samples of Turkish listed firms were correlated. Their study made a comparison of two different year within the same company 1998 to 2007 and the results shows that average collection period, inventory turnover, leverage profitability were in an contrary relationships that lead to growth profit association (Samiloglue and Demirnes, 2008). Maina (2013) conducted a research and investigated on the relationship between WCM and financial performance of the manufacturer firms listed in Nairobi stock exchange. Data was analyzed by applying descriptive and inferential statistics for the time period of 2007 to 2011 (Maina, 2013). It was found that inventory turnover in days had a negative relationship with Return on Equity (ROE). This means that the company's financial performance could be increased by reducing days in inventory.

Account receivables are current assets representing the liquidity of the company as an outcome obtained from the services rendered to its customers. It is an asset because the business expects to receive cash at any time according to the agreement, although sometimes it becomes a challenge if a firm's debtors fail to back the due. Kelly and McGowen (2010) suggested that customers who do not like to the pay back debts or do not pay at all brings problems to the firm. Nevertheless, a financial manager supposed to found a proper policy that controls the way of proposing credit by considering cost related with debts. However, the period for collecting cash from debtors should be clearly stated and the payment should be made according to the agreement. If the business fails to do so it leads to inefficient performance of the firm (Komba, 2017). Consequently, the managers should be strict in the managing debtor of the firm. The aim of management of debtors is to minimize the loss that occurs due to bad debtors. The firm manager should analyze the credit policy for effective debt management. This has an influence on the performance of the firm. Alipour (2011) conducted research about WCM and took a sample of 1063 listed companies in Tehran stock exchange. The test on hypothesis multiple regressions and Pearson correlation were used and it was found that they were a relationship between WCM and corporate profitability (Alipour, 2011). The researcher analyzed that sales and profit of a company is greatly influenced by the WCM. It is possible that a company may be incapable to pay its debts on time due inefficient WCM.

Managing accounts payable involves the timing of settlement of obligations to those supplying goods and services to the business. The firm should try to extend the period of payments as long as possible so as to take advantage of making other investments until payment has been made. Maness and Zietlow (2005) argued that extending the time for payment of the obligation, the producing companies requires to change the way of acquiring raw materials into finished goods that can be sold and brings return to an organization. A number of suppliers offer discount rates to their customers endeavor to pay debts before due date(Maness and Zietlow 2005). The firms should ensure it pays debts on time otherwise Paying after the due date should always be escaped this could only happen when the firm has fallen in financial challenges and there is no any other alternative (Henry, Robinson, Hendrik and Jan, 2011). The reason for late payments can cause preventable costs to the firm (Dolfe and Koritz, 2000). The average period is the days a firm takes to settle its obligations. Matungi (2010) explored in his study the relationship that occur between WCM and financial performance of oil marketing firms registered in Kenya with the petroleum institute of East Africa within Nairobi and its environment. The sample consists of 59 registered oil marketers in Kenya. The research noted that WCM decisions had effects on the companies risk return as well as share price. The study revealed that in order for a company to operate effectively account receivables & inventories must be monitored and controlled properly. Komba's (2017) conducted a study on the effect of having adequate level of WC for the growth and sustainability of a firm was emphasized on the influence of working capital management on profitability of the business.

Research Gap

Despite the noticeable empirical evidence from the reviewed literature, the reviewed and/or available studies did not assess the working capital management functions in SMEs where issues related to working capital are thought to be rife by a number of stakeholders. Moreover, most of the reviewed empirical studies were conducted outside Tanzania where social-cultural characteristics are different from that of Tanzania where the current study had been conducted. Thus, the researcher identified this gap and deemed it fitting to contribute to the existing literature through an assessment on working capital management function in relation to performance of the organization/firm and propose potential solutions that would otherwise address this problem particularly in small and medium businesses.

METHODOLOGY

In this study, the researcher adopted a mixed method approach under which a convergent parallel design was used. According to Creswell (2012), a convergent parallel design involves a simultaneously collection of both quantitative and qualitative data for the purpose of gaining a deeper understanding about the research problem. The advantage of this design is that it combines the virtues of both qualitative and quantitative data whereby quantitative data allows making generalizations and qualitative data provides information about the context (Creswell, 2012). The quantitative aspect in on the numerical and determination of opinion frequencies. The researcher adopted mixed method to gather quantitative information about working capital management function in relation to performance in the context of small and medium enterprises while the qualitative data assigned the overall meaning of the quantitative aspect by obtaining in-depth experiences of those in charge of the sampled SMEs.

The population were 4000 small and medium businesses registered in the Municipal area (Sumbawanga Municipal business office). However, majority of these businesses were the micro entrepreneurs, who dealt in businesses such as small family shops or necessities. The registered population who fit this study were 100 SMEs. The population for this study was therefore limited to 100 businesses. Saunders, Lewis, and Thornhill (2012) define sampling procedure as a process of selection of sample from the population. The researcher adopted non-probability sampling technique under which purposive sampling was employed. On the other hand, probability sampling technique under which simple random sampling was used. The sample size for this study was determined on the basis of the Research Advisors Tables (Research Advisors, 2006). In the context of this study, the Research Advisors Table suggested a sample size of 80, assuming the error margin of 5% (and 95% confidence level) for a population of between 90 and 100. The methods for data collection adopted by the researcher were primary data and used questionnaires for quantitative approach whereas semi-structured interviews were employed for qualitative method. The main reason for employing different data collection techniques was because of the probability of giving more reliable and valid data. Data analysis refers to examination of what has been collected in a survey or experiment and making deductions and inferences (Kombo and Tromp 2013).Descriptive statistics were then presented in frequency tables and percentages.The Statistical Packagefor Social Sciences (SPSS version 20) was used to run descriptive analysis to produce frequency distribution and percentages based on various characteristics of the respondents. On the other hand, the qualitative data from the interview guides were thematically analyzed in terms of narration while supporting with popular literature.

FINDINGS AND DISCUSION

Response Return Rate: Out of the targeted population of 100 SMEs business, a sample of 80 respondents was drown. Consequently, 80 questionnaires were distributed. A total of 73 questionnaires were returned which represent a response rate of 91.25%. This response was thought to be satisfactory for external validity.

The inventory management in an organization and its impact on performance: The first research objective sought to determine inventory management in SMEs and its impact on performance. Their responses were summarized in Table 2. The findings reported that firms maintained the required level of inventory; (98.75%) reported that firms had various stock levels; and (87.5%) reported that it the firms had an optimal (most favorable) order quantity required by the business. Moreover, the respondents agreed at (76.25%) that the firms determined stock turnover for each item; while (85%) of the respondents affirmed that the firms determined the cost of holding inventory, (92.5%) strongly agreed that the firm kept stock records. This implied that inventory management in most of the SMEs in the study area did not practice records keeping appropriately. Similarly, another interviewee shared a similar resentment that: To measure costs associated in ordering and holding inventory is difficult. This is because majority of SMEs in the municipal area lack skills on the inventory management. Therefore, WCM in terms of inventory management is affected hence the performance of the firms falls down (Interviewee 2, October 4, 2020). These outcome were consistent with the findings of Bachette (2010) that inventory management needs proper documentations of logical auditing of stocks in such a way that enables the firm to the required quantity of stock.

Policies governing management accounts receivable in an organization and its impacts on performance: The second research objective sought to assess the policies governing trade debtors and their impact on the performance of the firms. Seven items werepresented to measure the trade debtor's management. However, Respondents were questioned to show their degree of agreement or disagreement on those items. This information was analyzed and summarized in Table 3. Table 3 shows that (75%) of the respondents objected that the firms applied relaxed credit policy, only (7.5%) agreed that the firms applied stringent credit policy, while (17.5%) of the respondents were undecided. Similarly, (76.25%) confirmed that the firms tracked debtor's character. Moreover, (75%) reported that the firm limited credit sales. On the other hand (96.25 %) of the respondents strongly agreed that the firm's limited collection period of debts; (60%) of the respondents strongly objected that firms offered discount to customers. However, (88.75%) of the respondents agreed that the firms measured the ability of customers to pay debts. These findings implied that WCM function in SMEs was affected by credit policy made by the organization, relaxed policy, strict, credit policy, debtor character, limits of credit sales, as well as measurement of ability of customers on debt payment. This means that both have positive and negative impact on the performance.

The policies governing management accounts payable and their impacts on performance: This objective had six questions which were employed to measure the trade credit management practices. Generally, the responses provided by respondent showed to some extent an agreement with the credit policies suggested by the firm. This information was analyzed and summarized in Table 4. From Table 4 it can be observed that working capital management in relation to accounts payable impacts the performance:

Table 1. Response rate (n = 80)

Sample size	Number	Percentage %
Sample size	80	100
Responses	73	91.25
Impracticable	7	8.75
Total	**80**	**100**

Source: Field Data (2020)

Table 2. The inventory management (n = 80)

Variables	Rating Scale	Frequency	Percentage
The firm maintains required level of inventory:	Strongly Disagree	1	1.25
	Disagree	2	2.5
	Undecided	2	2.5
	Agree	44	55
	Strongly Agree	31	38.75
The firm has set various stock levels:	Strongly agree	34	42.5
	Agree	45	56.25
	Undecided	1	1.25
The firm has most favorable order quantity:	Strongly agree	25	31.25
	Agree	45	56.25
	Undecided	10	12.5
The firm determines stock turnover:	Strongly agree	24	30
	Agree	37	46.25
	Undecided	19	23.75
The firm keeps stock records:	Strongly disagree	1	1.25
	Disagree	1	1.25
	Agree	36	45
	Strongly Agree	38	47.5
	Undecided	4	5
The firm determines cost of holding inventory	Strongly agree	33	41.25
	Agree	35	43.75
	Undecided	12	15

Source: Field Data (2020)

Table 3 Accounts Receivable Management (n =80)

Variables	Rating Scale	Frequency	Percentage
	Strongly Disagree	37	46.25
Firm applied relaxed credit policy:	Disagree	23	28.75
	Undecided	14	17.50
	Agree	6	7.50
Firm applied stringent credit policy	Strongly agree	21	26.25
	Agree	46	57.50
	Undecided	8	10.00
	Disagree	5	6.25
Firm tracks debtor's character:	Strongly agree	23	28.75
	Agree	38	47.50
	Undecided	4	5.00
	Disagree	15	18.75
Firm limits credit sales:	Strongly agree	27	33.75
	Agree	33	41.25
	Disagree	6	7.50
	Undecided	14	17.50
Firm limit collection period:	Strongly Agree	40	50.00
	Agree	37	46.25
	Undecided	3	3.75
Firm offers discount to customer:	Strongly Disagree	48	60.00
	Agree	24	30.00
	Undecided	8	10.00
Firm measures ability of customers to pay debts:	Strongly Agree	20	25.00
	Agree	51	63.75
	Undecided	4	5.00
	Disagree	2	2.50
	Strongly Disagree	3	3.75

Source: Field Data (2020)

Respondents agreed that the firm maintained a level of debt to its suppliers (57.5%), 2) firms asked the creditors to extend the period for debt repayment (58.75% affirmed the statement); 3) firms were capable of paying debts on time (95% affirmed the statement); 4) respondents agreed that the firms limited credit purchase from suppliers (92.5% supported the statement); 5) that the firms' history on debt payment was good (95%) was supported the statement. Lastly, (76.25%) of the respondents supported the statement that the firms got opportunities for discount from suppliers. The findings imply that SMEs agreed with the policies that guides accounts payable, and that they have impact on management of working capital in relation to performance. Additionally, if days for paying debts are not well

Table 4. Accounts payable management (n = 80)

Variables	Rating Scale	Frequency	Percentage
Firm maintains level of debt to its suppliers:	Strongly Disagree	12	15
	Disagree	10	12.5
	Undecided	12	15
	Agree	28	35
	Strongly Agree	18	22.5
Firm ask the creditor to extend period for debt payment:	Strongly Disagree	11	13.75
	Disagree	6	7.5
	Undecided	16	20
	Agree	33	41.25
	Strongly agree	14	17.5
Firm is capable to pay debts on time:	Undecided	4	5
	Agree	58	72.5
	Strongly agree	18	22.5
Firm limits credit purchase:	Undecided	6	7.5
	Agree	42	52.5
	Strongly agree	32	40
The history of the firm on debt payment is good:	Undecided	4	5
	Agree	58	72.5
	Strongly agree	18	22.5
Firm have opportunities for discount from suppliers:	Strongly Disagree	11	13.75
	Disagree	4	5
	Undecided	4	5
	Agree	46	57.5
	Strongly agree	15	18.75

Source: Field Data (2020)

calculated this possibly had the impact on WCM function, hence poor the performance. This means that debt payment was an issue that affected SMEs. Also the findings in the study area revealed that SMEs do not understudy the policies guide credit sales. It seemed firms lack skilled personnel in business studies.

DISCUSSION OF THE RESULTS

Inventory Management in Firms and its Impact on Performance: The first objective of this study focused on determining how inventory management in SMEs was conducted and its impact on performance. It was found that SMEs maintained the level of inventory as per organization policy. These outcomes were consistent with the findings of Bachett (2010) that inventory management requires proper documentations of logical auditing of stocks in a way that enables the firm to the new order should made and how much is required to be ordered. The economic order quantity give proper direction on how much to order and when. Nevertheless, inventory transformed into debtors when transactions are made on credit and cash this was examined by (Gitman, 2009). Moreover, inventory level reduces possibility of stoppages in the production process or loss of customers due to insufficiency of raw materials and finished goods. There was a possibility of occurrence of positive relationship between SMEs, liquidity and profitability. This can happen when the average time required in changing materials into finished goods for sales, an increase in profitability can be predicted (Matur, 2012). Generally, the findings could be interpreted that if the level of inventory is not well balanced, it adversely affects profitability, hence poor performance. Hence, it important to have suitable optimal inventories in SMEs that may lead to adequate working capital in order to improve the performance of the business.

Policies governing management of accounts receivable and payable and its impact on firms performance: Research objective two sought to assess the policies governing trade credits in SMEs and its impact on the SMEs performance. The current study assessed that firms employed strict credit policies to its customers while reducing the number of debtor's exposed in the descriptive statistics that stringent credit policy have negative and positive effects debtor's management and the organization, because it guides management about how to control debtors by limiting credit sales and collection period(Mun and Jang, 2015). This helps in balancing between liberal and strict credit. Muhammad and Naimilbari (2012) conducted the study and reported a negative relationship between WCM and profitability of the company. The findings showed that rise in the number of accounts receivable it cause the possibility of having bad debts and doubtful debts, hence liquidity of the firm is affected adversely in the long-run. These findings were in line with WC rule that firms should ensure and struggle to make sure debts from debtors are quickly collected as soon as possible, this suggestion was examined by(Muhammad and Naimilbari, 2012). Therefore, when collection period increases, doubtful debts and bad debts rises, the performance in terms of liquidity and profitability fall down. However, late payments by customers or none payment created financial challenges to the frim. Oluoch (2014) is of the view that the period for collecting cash from debtors should be clearly stated and the payment should be made according to the agreement. If a firm is not restricted to limit credit sale and apply relaxed credit policy, financial performance is weak (Oluoch, 2014). In contrast, if the firm is able to sell products to customers who have ability to pay and the credit policy is strict, it raises liquidity and profitability which are two key objectives of working capital management. The accounts payable management in SMEs maintains the levels of debts to its suppliers, limit purchases and have a good reputation on debt payment. The suggestion to this study is that the firm should extend the period of debt payment in order to make investment while waiting for repayment. Matur (2012) suggested the firm who are able extend the number of day's for paying back debts to its suppliers linked to the increase in viability of the business hence an improved performance. The policy will lead to increase in liquidity, hence efficient working capital management. These results made sense that the more firm delays its payment to its creditors, the higher the level of working capital it reserved in order to increase profitability (Mansoori, Muhammad, Naimulbari. Ray, and Matur, 2012). The results implied that firms should delay the payments to suppliers in order for available of cash for their WC needed while being observant not to destroy their business image.

Conclusion

The management of current assets that means WCM, is essential when making financial decisions for an organization. Accordingly, an adequate level of WC should be present for the smooth meaning of a firm irrespective of the form of the business. If SMEs appropriately manage their inventories, debtors, and cash they will eventually advance their profitability and liquidity, hence, performance to the firm. The managers need to put more emphasis on the appropriate practice on keeping of inventory and determining the most favorable quantity to order, based on the underpinning cost associated with the carrying and holding inventories to ensure optimum performance. The computerized device system ought to be used in order to manage inventory as an alternative than the use of manual scheme. Therefore, firms must set up Information Technology (IT) in their operations to enhance effectiveness and efficiency in their working capital management. It is suggests that firms should ensure they have expertise in business studies such as accounting, finance, marketing, procurements and other related fields with required qualifications for proper management of working capital to ensure high business performance is realized. It is also recommended that SMEs in Sumawanga Municipal area should reassess the factors that govern their working capital management to enable them come up with the preferable working capital, that can alleviate against low profitability, financial challenges, poor competitive situation and lack of ability on the small and medium businesses to solve capital challenges to finance growth of their firm.

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