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Effect of Working Capital Management on Organizational Performance

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Abstract: The above study aimed at examining effects of working capital management on organizational performance. Both primary data and secondary data were used and analyzed to achieve our objectives. By using SPSS 16, the results from analysis of primary data showed that company sells more on cash than on credit, liabilities are well managed even in short period, and there is a good inventory management which helps the company to improve its performance. The t reduction of the days in accounts receivable will facilitate the company to have ready cash to reinvest them and can prevent the cash from getting battered by effects of inflation as well as benefit from cheap source of financing. The increase in inventory levels also will help the company to create value but may requires efficient level that can maximize returns and minimize the costs of keep it considering the effects of inflation. Thus working capital management is viewed as an effective way to increase cash flow and preserve, or even to enhance in the value of the company. It can also lead to increase and decrease in the business profitability.

Keywords: Working capital Management, organizational performance.

1. INTRODUCTION

The term working capital simply refers to the residue of the current assets over current liabilities. Working capital management (WCM) refers to all the management decisions and actions that ordinarily influence the size and effectiveness of the working capital (Kaur, 2010). It is a managerial accounting approach which focuses on maintaining efficiency levels of current assets and current liabilities to ensure that a firm has sufficient cash flow in order to meet its short term obligations. WCM is an essential part of financial part of financial management and contributes

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significantly to a firm's wealth creation as it directly influences organizational profitability and liquidity (Raheman and Nasr, 2007; Naser et al, 2013). The most important issue in WCM is the maintaining of liquidity in the day to day operations of the firm.

Working capital performance provides critical imminent into the state of a company's financial position. As an important indicator of financial fitness, the availability of a company's working capital is one of the first items a lender or shareholder will examine on a balance sheet (Financial Executives International Canada, 2013).

Long term finance and short term are two way of financing a business enterprise. Long term is requirement way a firm's needs for capital expenditure while short term financing is requirement for certain expenditure like procurement of raw materials, payment of wages, day to day expenditures.

2. LITERATURE REVIEW

The main theme of the theory of working capital management is the communication between current assets and current liabilities which involves managing the balance between a firm's short-term assets and short-term liabilities with an aim of ensuring to continuity of operations (Pandey, 2011).

Cash include money at hand, petty cash, bank account balance, Customer, customer cheques and it includes also a portion of unutilized portion of an overdraft facility or line of credit. Davidson (1992) defined cash management as a term which refers to the collection concentration and payment of cash.

Pindado (2004) also defines cash management as part of working capital that makes up the optimal level required by a company. Bort (2004) noted that, cash management is of importance for both new and growing businesses. Companies may suffer from cash flow problems because of lack of margin of safety in case of expected expenses such that they experience problems in finding the funds for innovation or expansion. Weak cash flow makes it difficult to hire and retain good employees (Beranek, 2000).

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Inventory is the raw material, work in progress goods and completely finished goods that are considered to be the portion of a business' assets that are set or will be ready for sale. Inventory control systems have been of concern for many years to business firms worldwide. Inventory control systems play a crucial role in attractive effectiveness and efficiency in handling inventory of business firms. Companies have been continually in search for sources of sustainable competitive advantage in their operations. Kenya manufacturing firms are facing competition in the current markets which has led to the need for coming up with better methods of managing and measuring how resources are utilized by various jobs or products, and therefore eliminate any wastagein the supply chain (Ondiek & Odera, 2012).

Accounts receivable refer the unpaid claims a firm has over its customers at a given time, typically comes in the form of operating line of credit and is mainly due within a comparatively short time period(up to one year). The volume of accounts receivable indicates firm's supply of trade credit while accounts payable shows its demand of trade credit. The study of accounts receivable and accounts payable during periods of financial calamity is an important topic, particularly when the global economy is going through a credit shock. During global financial crisis, characterized by high liquidity risk face by the banks, trade credits may increase, operating as a substitute for bank credits, or decrease acting as their complement. Bastos and Pindado (2012).

Accounts payable is an accounting entry which represents and entity's obligation to pay off a short term debt to its creditors. The accounts payable entry is found on a balance sheet under the heading current liabilities.

3. RESEARCH METHODOLOGY

Research design, population and the target population, sampling frame, sample and sample techniques, instruments, data collection procedure; data processing and analysis of research findings were described in this chapter.

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To stay consistent with other studies (Vural, Sokmen,&Cetenak,2012), the study used quantitative method to carry out properly the research. The researcher used this type of research because it is dealing with mathematical issues of how working capital management affects organizational performance.

In order to get complete data, the study used staffs from procurement department for stock; from operations; from marketing for Receivables; and finance department for the cash.

Due to lack of time and financial resources, the study made a sample to be able to conduct the research work. Sample size was not taken randomly rather was the real result of the calculation.

These are data that have been already collected by others and readily available from other sources. Such data are cheaper and more quickly available than the primary data. The researcher used data from company records such as audited financial statements, brochures, and so forth.

4. RESULTS

Findings revealed that satisfactory performance of manager would increase profitability by reducing CCC. DR and CCC are negatively correlated with GOP indicating that if both the duration increase, it will have a negative impact on the profitability. DP and INV are both positively correlated with GOP meaning that an increase in DP and INV leads to increase in GOP. Additionally, the results reveal that LNSALES and INFL are directly correlated with GOP indicating that profitability increase with increase in both size of the firms and inflation.

The research found out that DR has a negative effect on GOP meaning an increase in the DR leads to a decline in GOP. A one day increase in DR is associated with a 0.5% decrease in profitability. This negative relationship is consistent by the cost trade-off theory.

5. CONCLUSION& RECOMMENDATIONS

The main objective of this study was to assess effect of working capital management on organizational performance. Specifically, the researcher intended to explore the company's inventory conversion period on organizational performance , to examine how the company's average collection period influence the performance of the organization, investigating how the

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company's payables deferral period affect organizational performance and also exploring how cash in contribute to the company performance. Finally, the working capital management was found to have a significant effect on performance of the company.

Furthermore, with secondary data got from various firms , the researcher has run tests of regression analysis to inspect the effect of working capital management on firm profitability. The results revealed that DR and CCC have a negative effect on GOP while DP and DI are positively related to GOP. This implies that by shortening collection period and CCC Company may increase their profitability and an adequate and timely flow of inventory is imperative for the success and growth of any company. Also, Control variables LNSALES and IR were found to have different effects on the choice company' working capital policy. Thus working capital management is viewed as an effective force to increase cash flow and preserve, or even to enhance company value.

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