Working capital management and financial performance

[Business](), [Management]()

INTRODUCTION

Agricultural products are central to Kenya`s export industry with horticultural and tea being the most important. Kenya contributes about 10% of the global tea exports. With 45, 000 small scale tea farmers each with an average family of six, approximately three million Kenyans earn their livelihood on small scale tea growing. This is almost 7% of the Kenyan population. This means that this sector is very crucial and should be given much attention by the government.

Working capital management deals with the management of all the aspects of both current assets and current liabilities to minimize the risk of going bankrupt and at the same time increasing returns on assets (FTC Faulks Lynch, 2005). Efficient working capital management demand maintaining sufficient level of current assets and liabilities to facilitate achievement of optimal profit levels augmentation of shareholders wealth. According to Singh & Asress (2011), a well-organized working capital management has a considerable participation on financial performance of a firm.

Working Capital Management

Working capital is the difference between a firm`s Current Assets and Current Liabilities. It is all the short-term assets used in the daily operations of a firm. Working capital management refers to the basic principles and guidelines that a firm use when controlling their working capital. Financial risks in a firm can be minimized and overall performance improved if well-thought working capital management is employed (Nazir & Afza, 2009). Working capital management policies are vital in financial management decision implying that insufficient management of working capital cripples firms, thus an optimal level of working capital is vital for continuous inflow of profits to an organization (Hapton, 1989).

Working capital management requires a combination of techniques which include, payables management, cash management, inventory management and receivables management. The main aim of working capital management is to maintain an optimal balance between each of these techniques (Felbeck & Krueger, 2005). It is necessary for companies to monitor overall trends in these components so as to detect areas that require closer management. In achieving this, different methods and strategies are applied to effectively control each components of working capital. (Kieschnick et al. , 2013) states that working capital components need to be considered jointly because of their interconnected nature.

Financial Performance

Financial performance is the process of measuring the results of a firm`s policies and operations in monetary terms (Erasmus, 2008). It identifies the financial strengths and weaknesses of a firm by establishing the relationship between items of the financial position and income statement. Financial performance has been the primary concern in all types of organization since it has implications to organization`s health and ultimately its survival. According to (Berger & Patit, 2002), financial performance of a firm relates to its motive to maximize profit both to shareholders and on assets.

Working Capital Management and Financial Performance

The subject of working capital management and financial performance has received significant attention from scholars in the various areas of business and strategic management. A well-organized Working capital management has a considerable participation on financial performance of a firm (Singh & Asress, 2001). When a firm appropriately manages its working capital and keeps a positive a balance to meet short-term obligations, and to take advantage of short-term opportunities, it increases its profitability (Shaw, 2006). According to Delof (2003), the chief purpose of each financial manager is to increase firm`s profitability. In order to achieve this goal, efficient working capital management is indispensable because working capital has an impact in the profitability of firms. This study will test to know how the variables of working capital management affect the profitability of KTDA managed tea factories.

KTDA Managed Tea Factories in Region Three.

KTDA is the agency which manages all the tea processing factories which serves the small-scale tea farmers in Kenya. The agency manages tea factories to effectively manage costs, offer extension services to the farmers on their tea farms, oversee production processes, selling the final product to the customer, pay farmers and invest prudently to secure farmers` financial future. Currently, KTDA manages 64 tea factories distributed across eight tea-growing regions. Region three which is called the Mt. Kenya region has eight factories which includes; Ndima, Kangaita, Mununga, Kimunye, Thumaita, Kathangariri, Mungania and Rukuriri tea factories.

Statement of the Problem

Currently, Kenya is the biggest exporter of black tea globally (Kenya Tea Directorate, 2017). The tea sector is the most important subsector in Kenya contributing to about 26% of the total foreign exchange earnings (KTDA, 2016). In order for the Kenyan economy to achieve its millennium goals of becoming an industrialized country and also achieve its vision 2030, contributions from the tea sector are critical. The tea sector over the recent past has contributed greatly to the country GDP, and to innovations in the country. Tea farming contributes immensely towards employment directly to farm owners and workers on farms and to this industry and service sectors (Nyangito & Kimura, 1999).

However, during recent years, the Tea industry in Kenya has been facing several challenges and among them is low returns for small scale farmers. According to Gakaria (2015), small-holder tea farmers` returns have continually remained dismal. The farmers earning low bonus have threatened to abandon tea farming or sell their tea to the highest paying bidders unless KTDA harmonizes the bonus payments. According to (Isaac Kibet et al., 2017) the performance of tea processing firms has not been satisfactory to the farmers due to wide variation of bonus payment from one firm to another. KTDA has attributed this poor returns and the variation in bonus payment among the tea processing factories to working capital management practices adopted by various factories (KTDA, 2016). These evidences have set a research gap into the relationship of working capital management and financial performance of KTDA managed tea factories. Working capital management is an integral aspect for a firm performance that needs to be considered both for short and long-term operational goals (Lamberson, 1995). Working capital decisions are imperative in ensuring all recurrent expenses are paid and for smooth business operations. Many businesses have failed because of the inability to effectively manage their working capital (Krueger. 2005).

According to Tea Board of Kenya (2012), most tea factories have experienced deteriorating performance associated with high costs of operations, stiff factories competition among others. (Gakii, 2017) conducted a research on the effect of working capital management on the financial performance of tea factories in Tharaka Nthi and Meru and concluded that working capital management is very important component of financial performance as it directly affects liquidity and profitability of these companies. Kibet et al (2017), conducted a research on working capital management practices and financial performance of tea processing firms in Kenya and concludes that inventory management policy has a negative relationship with the financial performance of tea processing firms while payables management practices had a positive relationship with financial performance of tea processing firms.

It is clear that little study has been conducted on how working capital management affects financial performance of KTDA managed tea factories. A knowledge gap exists; therefore there is a compelling need to test whether there is any relationship between working capital management and financial performance of KTDA managed tea factories. Further, this study seek to bridge the existing knowledge and literature gap by trying to answer the research question, what is the relationship between working capital management and financial performance of KTDA managed factories in region three?