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WORKING CAPITAL MANAGEMENT PRACTICES AND PROFITABILITY OF SMALL AND MEDIUM ENTERPRISES IN KENYA: CASE OF FAST-MOVING CONSUMER GOODS ENTERPRISES IN ISIOLO COUNTY

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Abstract

SMEs plays important role in all sectors of the economies worldwide. They act as stimulus to economic development and generation of employment. The study investigated Fast-Moving Consumer Goods (FMCG) enterprises in Isiolo County, Kenya to find out the best working capital practices that were in use, with a view of identifying capital management gaps and proposing the best practices to be adopted to increase profitability. The objective of the study was to determine whether inventory management practices affect profitability of FMCG enterprises. The target population was sixty-three (63) FMCG enterprises operating in Isiolo County, which was represented by respective owners or appointed employees. The study adopted census technique, hence selecting all 63 FMCG enterprises licensed by Isiolo County Government as the sample population. A structured questionnaire was administered on the sample population and data was collected during working hours. Data was analysed with the help of Statistical package for Social Sciences (SPSS).Hypothesis testing was conducted using Analysis of Variance (ANOVA) while relationships between variables were established using Multiple Regression. Findings were presented and discussed using frequency tables. The key *finding of the study was that inventory management has significant effect on profitability of FMCG enterprises. The study recommended that FMCG enterprises in Isiolo County need to review and refine their inventory management practices, preferably by adopting technology.*

Keywords: Inventory Management practice, Small and medium enterprises, Fast moving consumer goods, Profitability

INTRODUCTION

Small and medium enterprises play key roles in various economies worldwide. There are challenges faced by firms in management of working capital and this affects profitability. Small and medium enterprises are the backbone of all economies and their importance as an impetus to economic development especially in developing economies cannot be over-emphasized. They serve as dynamic forces and agents of change as they stimulate economic growth. The small and medium scale enterprises generate at least 60% of the USA GDP (Deloof, 2003).

Small and Medium enterprises have emerged has the main driving forces of economic growth and development in Kenya. According to economic survey of 2006, SMEs contributed over 50 % of new jobs created in year 2005 and 20 % of GDP of Kenya. The government also estimates that SMEs employment is growing at a rate of 11 % p.a. They have contributed greatly in strategies put in place to alleviate poverty, creation of jobs as well as attainment of millennium goals. The Kenyan government has taken steps to develop a legal and regulatory framework, markets and marketing, businesses linkages, the tax regime, skills and technology and financial services (ROK 2005, 2010).

The government of Kenya in its blue print of 2010 acknowledged the country to move towards a newly industrialized middle-income country capable of providing high quality of life to all citizens by the year 2030, SMEs needs to be strengthened -ROK, 2010). The SMEs have been boosted by government in areas such as training, provision of physical structure, marketing of their services and provision of credit facilities (ROK 2010). Regardless of this immense support towards the SMEs they are faced with a threat of failure having past statistics indicating that three out of five fail within the first few months (Sonia 2009). According to Sonia, most of these failures are attributed by working capital management. The firms are not concerned with their working capital position, procedures of giving out credit and recovering, procedures of acquiring and settling credits and procedures of acquiring and paying loans. Many do not care about their financial position, they only run business and they most focus on cash receipts and what their bank position is. (Sunday, 2011). (Nyamao, 2012)

Statement of the Problem

Isiolo County is a developing county in Kenya. According to sessional paper no. 10 of 2012 it has been identified as a gateway for development of Northern parts of Kenya. Consequently, wholesale and retail trade has been highlighted as part of main economic driver by Kenya Government in its blue print of development as a major city in attainment of vision 2030. It is attracting businesses of all kinds. According to a national survey done by KNBS in 2016 SMEs contributed 33.8 percent to national GDP in 2015 and 81.1 percent of employment. The survey established that there were 1.56 million SMEs licensed by county governments while the unlicensed business identified from the households were 5.85 million. A total of 2.2 million SMEs was closed in the last five years, 2016 inclusive. The closed businesses consisted of majority of SMES which accounted for 73.5 percent. On average the businesses closed at 3.8 years. It is on this basis that the researcher investigated whether this close down could be attributed to poor working capital management. This needed to be established in order to sustain businesses for future growth and expansion to stand test of time. Therefore, this research investigated FMCG enterprises in Isiolo County in order to find out the best working capital practices that were in use, with a view of identifying capital management gaps and proposing the best practices to be adopted. SMEs that are not compliant to these aspects will utilize the findings for future prosperity. The findings of this study will help actualize Kenya Government vision 2030. Given there was no specific research studies exclusively on effect of working capital management and profitability of fast-moving consumer goods enterprises in Isiolo County the study purposed to bridge the gap.

Objective of the study

To determine whether inventory management practices affect profitability of FMCG enterprises in Isiolo County.

Research Hypothesis

H_{01}: Inventory management practices has no significant effect on profitability of FMCG enterprises.

LITERATURE REVIEW

The study employed Resource based theory has its theoretical foundation. This theory was developed by Wernerfelt (1986). It provides a frame work for understanding the importance of organization resources and offers an explanation that performance and sustainability of an organization depends on the resources owned and controlled by an organization. Resources are the basis of business survival and corporate profitability. The resources could either be human or material.

Resource-based theory is used in this context to include the assets controlled by enterprises in terms of inventory and the cognitive ability of individual managers of businesses as to ensure effective management of the short-term asset of the business (Alvarez & Busenitz, 2001). Provision of physical resources and adequate materials enables a firm to cater for its customers effectively yielding high profits. Resources inertia leads to low profitability.

Inventory Management and Profitability of SMEs

Inventory management has been identified has one of key components working capital of an enterprise. The management of inventory affects the level of profits realized by a firm. Holding excess stock leads to high stock handling costs, deterioration in the value of stock, theft and pilferage of employees. Total of the costs to a firm reduces its profitability. Inadequate stock leads to stock out costs and loss of goodwill leading to loss of profit. Holding inventories at high levels leads to high capital tied up in stock and loss in profitability due to forgone interest income that would be earned by investing tied up capital in stock (Saleemi, 2009).

Conceptual Framework

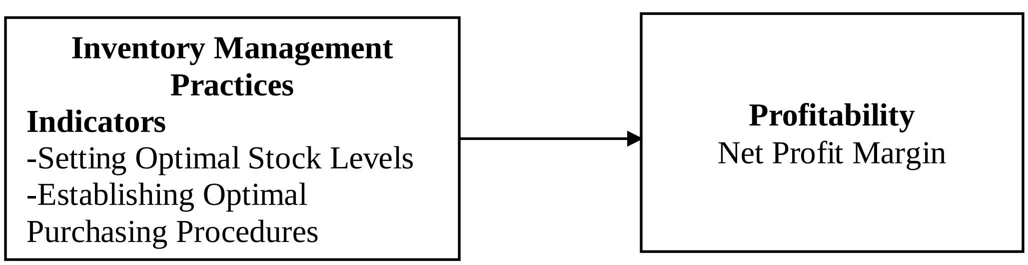

Figure 1 Conceptual Framework

RESEARCH METHODOLOGY

The study employed a descriptive survey design to assess the effects of inventory management on profitability FMCG enterprises in Isiolo County. The study applied both qualitative and quantitative methods. Both descriptive and inferential statistics were used to derive information needed to test the research hypotheses.

The study was conducted at Isiolo County. This county serves as a gateway to development of northern part of Kenya and major city in attainment of Kenyan Government Vision 2030. Literary work revealed that no studies of this kind had been done previously in this region and the researcher purposed to investigate practices adopted by entrepreneurs.

The target population for this research was sixty-three (63) owners and employees of fast-moving consumer goods enterprises operating in Isiolo County. Table 1 summarizes the population distribution across main urban centres.

Table 1 Population

Towns	Frequency	Percent
BullaPesa	37	58.7
Wabera	13	20.6
Kinna	6	9.5
Garbatulla	4	6.4
Sericho	3	4.8
Total	**63**	**100.0**

The study adopted census technique because the target population was less than 100. Thus, all the 63 FMCG enterprises licensed by Isiolo County Government were included in the study. (Isiolo Licensing Board, 2018). According to (Saunders, Lewis & Thornhill 2009) a census approach enhances validity of the collected data by including certain information-rich cases for study.

The researcher used questionnaires to collect the data. This gave the respondents flexibility to fill the questionnaire at their convenient time. The study used primary data which was collected mainly through questionnaires. The questionnaire captured patterns and trends practiced over time. It also helped the researcher to collect relevant data. The questionnaire contained both closed and open-ended questions. The instrument was administered by the researcher and research assistants.

Statistical Package for Social Sciences (Version 21) was used to analyse the data. The data collected was coded. Data entry and data cleaning was done. The data was analysed using descriptive and inferential statistics. Through the results regression analysis correlation and coefficient of determination were attained. Correlation analysis helped to establish the nature of relationship between independent variables and dependent variable. Coefficient of determination was carried out to establish how strong independent variables were associated. Multiple Regression analysis was done with profitability (NOP) being the dependent variable by use of the following model.

$Yi = \alpha + \beta 3(ITID)i + e$

Where:

Yi= Net Operating Profit (Profitability) of firm i

α= Constant term for the independent variable β= Regression Model Coefficient

e = Error Term

ITID- Inventory Turnover in Days

ANALYSIS AND FINDINGS

Descriptive Statistics

A total of 63 questionnaires were distributed to owners and appointed employees of Fast-Moving Consumer Goods enterprises. The results shown that majority of the respondents (41.3%) did not take stock regularly. Further, a cumulative majority (66.9%) were not regular stock-takers hence increasing the possibility of poor business performance occasioned by loss of goods, a cumulative majority of respondents (65.1%) did not have inventory control systems in their business hence raising the possibility of having either excess or inadequate supply with both possibilities being unfavorable for business. Additionally, majority of the businesses (95.2%) replenished their stock in time to meet the demands of customers. The study also established that a cumulative majority (80.9%) of the respondents opined that high inventory turnover was eating into their businesses' profitability. This implies that FMCG enterprises were incurring high costs in storage and management of stock. Also, majority of the businesses (57.1%) restocked on a weekly basis. In addition, a cumulative majority (90.5%) had an average monthly stock of between Ksh 500,000 and over Ksh 1,000,000. It was also established that majority of the businesses (38.1%) had stock valued between Ksh 500,001 and Ksh 1,000,000.

Regression Model Summary

Subsequently, the test of the hypothesis between inventory management practices and profitability of FMCG enterprises was performed.

Table 2 Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	20.870	3.149		6.627	.000
	Inventory Management	-.215	.146	-.185	-1.471	.000

a. Dependent Variable: Profitability of FMCG enterprises

Results in Table 2 show that the partial regression coefficient for the independent variable is negative. This indicates that there exists a negative relationship between inventory management practices and profitability of FMCG enterprises in Isiolo County. The relationship is statistically significant as shown by a p-value (0.000) which is less than 5%. Therefore null hypothesis that inventory management practices have no significant effect on profitability of FMCG enterprises is rejected. This implies profitability does depend on inventory management practices.

The finding of the study was that inventory management practices affects profitability of FMCG enterprises in Isiolo County. This finding is in agreement with that of Gakure (2012) and Kumar (2013).

CONCLUSSION AND RECCOMEDATION

Based on the study findings, it was concluded that inventory management practices affect profitability of FMCG enterprises in Isiolo County. There is significant investment in this type of business in Isiolo County. Majority of the businesses replenish their goods on a weekly basis, a common characteristic of FMCG enterprises. It is evident that most businesses have poor inventory management practices thus affecting business profitability negatively. Majority do not keep accurate business and accounting records and fail to take stock regularly. Such omissions lead to low profitability considering the possibility of theft by servant and failure to meet the demands of customers respectively. It is not surprising that FMCG business owners have no inventory management systems in place. However, despite lacking inventory management systems, businesses replenish their stock to meet customer demands, perhaps owing to close proximity to suppliers and availability of goods on credit from suppliers. The bottom line, however, is that business profitability is likely to suffer owing to lack of an effective inventory system. These findings are in tandem with those by Kumar (2013), Singh (2008) and Shahid (2011).

Based on the findings, it was recommended that FMCG enterprises in Isiolo County need to review and refine their inventory management practices, preferably by use of technology, to ensure they are updated on not only customer demands but also amounts of goods available to meet these demands.

The study encountered language barriers when collecting data from business owners, especially those in Garbatulla and Merti areas of Isiolo County. Moreover, some trading centers were unreachable due to insecurity and poor accessibility. These limitations lead to lack of generalizabilty of the findings.

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