WORKING CAPITAL MANAGEMENT AND FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KAMPALA CENTRAL DIVISION, UGANDA

BY

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DECLARATION

I, Mohamed Abdullahi Mohamud, do hereby declare that the content of my study herein, to the best of my knowledge, is my original work and has never been presented for a degree of any institution.

Sign 18/05/18

Date ...18-05-2018...................................

APPROVAL

I certify that the work submitted by this student was under my supervision and is now ready for the award of masters' degree in management of Kampala international University

Supervisor:

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Date 18/05/2018 ....

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DEDICATION

I dedicate this work to my parents, friends and family members for their moral and financial support and the encouragement that they gave me during the study.

ACKNOWLEDGEMENTS

I wish to acknowledge and be grateful to Allah for enabling me to reach this point in my academic life and I am so thankful for His unconditional protection.

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ABSTRACT

The purpose of the study was to investigate the effects of working capital management (WCM) on financial performance of small medium enterprises (SME's) in Kampala Central Division with a view to establishing a model directed at improving SMEs' performance and it was hypothesized that working capital management practices positively influence SMEs' financial performance. The dependent variable of the study was profitability measured with ROA and ROE which is used as a proxy for financial performance. Cash management, receivables management, inventory management, and payables management were taken as major components and constructs of working capital management which is the independent variable of the study. Four hypotheses were formulated which are in line with study objectives. Pearson's linear correlation coefficient and regression analysis were conducted in testing the hypotheses; and the study adopted quantitative approaches with descriptive and correlation designs. The study used a respondent sample of 327 SMEs operating in Kampala Central Division whose managers and owners/managers were the unit of enquiry. The findings in respect of the main purpose of the study indicated that working capital management accounted for 31.4% of the variance in profitability of SMEs. The results from the working capital management components revealed that cash management, receivables management and inventory management had a significant positive relationship with financial performance, while payables management had non-significant negative relationship with financial performance. The study supports the trade-off theory in explaining the financing of SMEs together with agency theory as the theories that help in explaining business performance of SMEs. The study confirmed efficient working capital management practices improve financial performance of SMEs. As a result, one of the most prominent findings of the study is that it has provided evidence to support the fact that components of working capital can improve the state of profitability of SMEs in Kampala. Policy makers, SMEs owners, academicians and future researchers may use these findings; as it provides a better understanding and deeper insights into working capital management practices and presents recommendations that in turn bring improvements in the financial performance of SMEs in Kampala. Hence, to increase the profitability of SMEs in Kampala Central Division, the study recommended owners and managers of SMEs to plan and control working capital efficiently in such a way to maintain the working capital components in an optimum level to balance the trade-offs between the benefits and costs of short term financing.

ABBREVIATIONS AND ACRONYMS

EU	European Union
GDP	gross domestic products
OECD	Organization for Economic Cooperation and Development
ROA	Return on Assets
ROE	Return on equity
SME	small and medium enterprises
UIA	Uganda Investment Authority
UNDP	United Nations Development Program
UNIDO	United Nations Industrial Developmental Organisation
WCM	Working capital management

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

This study investigated Working Capital Management and financial performance of the SMEs in Kampala, Uganda. This chapter entailed the introduction to the study, background to the study, problem statement, purpose of the study and the research objectives. It also gives the research questions, hypothesis, scope and significance of the study, and also operational definitions of key terms.

1.1 Background to the Study

1.1.1 Historical Perspective

Since 1960s to date, small and medium sized enterprises (SMEs) have been given due recognition especially in the developed nations for playing very important roles towards fostering economic growth, development and stability within several economies; they make-up the largest proportion of businesses all over the world and play tremendous roles in employment generation, provision of goods and services, creating a better standard of living, as well as immensely contributing to the gross domestic products (GDPs) of many countries (Mabonga, 2014). However, it appears that considering the enormous potentials of the SMEs sector, and despite the acknowledgement of its immense contribution to sustainable economic development, its performance still falls below expectation in many developing countries (Tobechukwu, 2012).

Globally, the population of SMEs changes constantly with many businesses being born every year while many cease to operate. In particular, young and small firms show high mortality rates. Moreover, interest in SMEs also seems to have been further revived in the face of globalization, which is increasingly becoming an influential force in the world trade (EU Annual Report of SMEs 2015-2016). SMEs represent over 93% of all enterprises and contribute to 60%-70% of employment and generate a large share of new jobs creation in EU member states (OECD, 2017). However, many young enterprises fail in their early years and barriers to starting afresh dampen the potential gains that a strong start-up culture could yield. According to the EU Annual Report of SMEs 2015-2016, it seems that EU member states have escaped from the fallout of the economic and financial crisis of late 2008 and 2009. Indeed, following a number of years of poor economic performance, EU member states experienced in 2015 a good growth in value added for the second year in a row (3.8% in 2014 and 5.7% in 2015).

In India, SMEs had crucial historical role in generating employment and income at regional level and acting shock-absorber during periods of economic crisis. The SME sector has continued to contribute immensely in creating large scale job opportunities across space and, in the process, helped reduce inter-regional and rural-urban disparities in growth. However, the full potential of the SMEs in the developmental process has not been realized, owing to various constraints, the performance of SMEs in the global market generally and in the Indian particularly was unimpressive and still falls below expectation (Jaimin, 2016).

In many African countries including Uganda, the contribution of Small and Medium Enterprises (SMEs) has been recognized as main sustenance of the economy because of their capacity in enhancing the economy output and human welfare (Akingunola & Oreoluwa, 2011). SMEs represent over 90% of private business and contribute to more than 50% of employment and of GDP in most African countries (UNIDO, 1999). SMEs are highly valued, especially in developing economies for many reasons. In Nigeria despite its abundant natural resources and rich environment, the economy of Nigeria has not quite taken off and most organizations do not operate smoothly and efficiently (Okechukwu, 2014).

Small and medium-sized enterprises (SMEs) form the back bone of the private sector, making up approximately 90% of Uganda's private sector and contribute two-thirds of national income (Kisaame, 2002). SMEs generate employment, add value, bring in foreign exchange and investment, improve labour skills, and have linkages with large organizations (Sarapaivanich, 2003). Therefore sustainable development and employment cannot be achieved without SMEs. The SME sector plays a vital role in the economy especially on job creation, innovation, promotion, and subsistence incomes. Small and Medium Enterprises (SMEs) in Uganda employ more than 2.5m people, constitute up to 90% of the private sector and contribute over 70% to total GDP (Byaruhanga, 2014).

1.1.2 Theoretical Perspective

This study was guided by the trade-off theory of Kraus & Lichtenberger (1973) which was later developed by Myers in 1984; and the Agency theory of Stephen Ross and Barry Mitnick in 1973 and expanded by Jensen and Meckling in 1976.

1.1.2.1 The Trade-Off Theory

The trade-off theory was initiated by Kraus and Lichtenberger in 1973 and developed by Myers in 1984. The theory explains how a company chooses to finance its business by considering two perspectives, either debt finance or equity finance. The theory states that, it is the responsibility of business managers to make proper decisions on how much debt finance and how much equity finance to use by balancing the cost of the debt and benefit of the debt (Kraus & Lichtenberger, 1973).The trade-off theory suggests that businesses seek to maintain optimal level of liquidity to balance between the benefit and cost of holding cash (Matemilola & Bany-Ariffin, 2012). The holding of optimum cash levels means that the firm can save transaction costs to raise funds, that is, current assets and meet its financial obligations, that is, current liabilities (Waithaka, 2012). The trade-off theory also suggests that the major concern of business is the effective management of the day-to-day operations in a smooth manner while increasing the shareholder's profit (Nazir & Afza, 2009). In this context, the businesses must manage their current assets and liabilities prudently. Minimization of funds tied in the current assets implies that the freed up funds can be invested hence improving financial performance of a business (Lazaridis & Tryfonidis, 2006).

However, a well-managed working capital promotes a company's position on the market in terms of profitability and growth of shareholder's value (Kosgey & Njiru, 2016). Investment in working capital involves a balance or a trade-off between risk and profitability because investment decision which leads to increase in profitability will be inclined to increase risk and vice versa. Efficiency in managing Working capital also increases cash flow to the companies which in turn increase the growth opportunities for the companies and return to the shareholders (Shaskia, 2012). Working capital management is a continuous function which is linked to the company's survival. Companies where working capital management is not given enough attention cannot survive for a long period (Dong and Su, 2010). By putting into consideration the idea advanced by the theory, working capital management is a very crucial part of a firm's financial management because its management not only affects the survival of company but the profitability of the company also depends on how effectively and efficiently working capital is being utilized. Therefore, it is vitally important to see how a trade-off can be maintained in working capital management and financial performance.

1.1.2.2 The Agency theory

The agency theory was propounded by Stephen Ross and Barry Mitnick in 1973 and expanded by Jensen and Meckling in 1976. The agency theory is a supposition that explains a contractual relationship that exists between the principal (owner) and the agent (manager) in a business. Within a business, an agency relationship is a contract in which the principal (owner) engages an agent (manager) to perform some service on behalf of the principal (owner) which involves delegating some decision-making authority (Jensen & Meckling, 1976).

The agency theory is concerned with resolving problems that can exist in agency relationship due to unaligned goals or different aversion levels to risk. This theory addresses problems that arise due to differences between the goals and desires of the principal and the agent. This is because the principal is not aware of the actions of the agent. Jensen & Meckling (1976) argue that agency problems emanate from conflicts of interest, for example, the agent may have a desire to expand the business into other markets for a prospective growth and higher earnings in the future. However, principals that desire high current capital growth may be unaware of these plans. This may as the result lead to a conflict of interest between the principal and the agent; hence the profitability of the business for prospective growth will negatively be affected. The theory also assumes that principals and agents act rationally and use contracting to maximize their wealth (Fama & Jensen, 1983). In the principals 'effort to maximize their own wealth, agents may face the dilemma of acting against the interests of their principals. Jensen & Smith (1984) suggest that agents need constant supervision and management; otherwise, they will tend to pursue their own interests rather than those of the owners. Agency theory also provides a useful theoretical framework for the study of the working capital management. Managers act as agents to their principals of which they have an obligation to protect the interest of their principals. This Theory was chosen for this study for the reason that —management of working capital components is one of many mechanisms used in business to address the agency problem which results in financial performance of an organization (Jensen & Payne, 2003).

Many theories have been developed to explain the management of working capital. The agency theory also contributes to the working capital management decision. Therefore, the theory will help in trying to investigate if firms that present monitoring mechanisms of managers' actions have lower level of working capital requirement.

This theory relates to working capital management components from the perspective of cash management, trade receivables and inventory management. The manager is the firm's shareholders agent and makes all paramount decisions that concern the receivables and the inventory of the business. His decisions have a very big impact on the shareholders wealth this is due to the fact that if he might fail to sell to creditworthy customers resulting in reduced revenues due to low sales. This will in fact be favourable to the credit manager since he will not have to follow up on debt collection whereas the sales department will be disadvantaged. On the other hand, he might decide to sell unknowingly to un-creditworthy customers, which will result in an increase in bad debt expenses and thus reducing the shareholders wealth. The agency theory seeks to find a balance between the agent (manager) and the principal (owner) such that the manager's decisions always have the top interests of the owners at heart.

1.1.3 Conceptual Perspective

With Working Capital Management is referred to the net working capital (Shaskia, 2012). Working capital is the difference between current assets and current liabilities (Adeniji, 2008). Working Capital Management involves planning and controlling current assets and current liabilities in a manner that eliminates the risk of inability to meet short-term obligations and avoid excessive investment in these assets (Eljelly, 2004). Working Capital Management focuses on the coordinated control of the firm's current assets and liabilities (George, 2010). Current Assets are assets such as cash and cash equivalents, short-term investments, trade and other receivables, prepaid expenses, inventories and work-in-progress (Wambugu, 2013) which in ordinary course of business can be or will be converted into cash within one year without undergoing a diminution in value and without disrupting the operations of the firm (Mathuva, 2010). On the other hand, current liabilities are liabilities such as trade payables, short-term debt and accrued liabilities (Mugo, 2012) which are intended at their inception, to be paid in the ordinary course of business, within a year, out of current assets or earnings of the concern (Mathuva, 2010). Working Capital Management aims at maintaining an optimal balance between each of the working capital components, that is, cash, receivables, inventory and payables (Nazir & Afza, 2009; Okinyi, 2014). The goal of Working Capital Management therefore, is to ensure that the firm is able to continue in its operations and that it has sufficient cash flow to satisfy both maturing short-term debt and upcoming operational expenses (Brigham & Houston, 2007) and the success of any business depends on the effective management of cash, inventories, receivables and payables (Filbesck & Krueger, 2005).

For the purpose of this study, Working Capital Management is conceptualized as cash management, receivables management, inventory management, and payables management practices which are taken as major components and constructs of Working Capital Management.

Financial performance is the process of measuring the results of a firm's policies and operations in monetary terms (Kabethi, 2013; Ismail, 2016). It is a subjective measure, of the degree to which financial objectives have been accomplished (Padachi, 2006). It is also used as a general measure of a firm's overall financial health over a given period of time and can be used to compare similar companies across the same industry (Maymand, 2014). Machiuka (2010) argues that the analysis of financial performance reflects the financial position of the company, the level of the competitiveness in the same sector, and a thorough knowledge about the cost and profit centres within the firm. Financial performance of a firm has been measured, by different authors (Karaduman et al, 2004; Padachi, 2006; Garcia & Solano, 2007; Melicher & Leach, 2009; Enqvist et al, 2011; and Sharma & Kumar, 2011), using variables such as profitability, financial efficiency, and liquidity. Profitability measures the extent to which a business generates a profit from the factors of production. It indicates how efficiently the management can make profit by using all the available resources, i.e. factors of production (Harward& Upton, 1961). The most useful measures of firms' profitability are Return on Assets (ROA), and Return on Equity (ROE). Return on assets (ROA) which is the net income for the year divided by the total assets (Ogoye, 2013), defines a firm's ability to utilize its assets to generate profits. Profit earned on capital invested is often a more indicative measure of financial performance than in the level of profits as a percentage of sales. Return on Equity (ROE) that is the internal performance measure of shareholder's value (Machiuka, 2010). ROE refers to how much profit a company earned compared to the total amount of shareholder equity invested or found on the balance sheet. ROE is what the shareholders see as a return to their investment. Financial efficiency means releasing cash quickly from inventory and through collections of accounts receivable, creating repayment sources that enhance credit-worthiness. Assets turnover, inventory turnover are measures of financial efficiency (Matama, (2008). The liquidity measures the ability of the business to meet financial obligations as they come due, without disrupting the normal, ongoing operations of the business (Okinyi, 2014). The current and acid test ratios are fundamental measures of liquidity.

However, for the purpose of this study, financial performance is conceptualized in terms of profitability and is measured with Return on Assets and Return on Equity.

1.1.4 Contextual Perspective

The term SME covers a wide range of perceptions and measures, and to date there is no universally accepted definition of small and medium enterprises varying from country to country, from industry to industry and between the sources reporting SMEs statistics (Byaruhanga, 2014). Some of the commonly used criteria are the number of employees, total assets, sales and investment level. However, the most common definitional basis used is employment, but, there is a variation in defining the upper and lower size limit of an SME (Ayyagari, Beck & Demirguc-Kunt, 2003)

SMEs in Uganda are mostly owner–managed and the efficient management of the working capital is one of the key factors that influence its performance in terms of profitability. In Uganda, efforts have been made to improve the leasing competences of SME owner-managers. Enterprise Uganda in collaboration with Uganda Investment Authority, supported by UNDP has facilitated training programs focusing on leasing competence development among SMEs managers and within a year, 3500 SMEs had benefited (UIA, 2008).

SMEs are making positive contributions to economic growth and development in Uganda, although the rate of failure is also high (Kazooba, 2006). The performance of SMEs in terms of profitability, are in most cases hindered by little attention given to areas that influence business efficiency. Efficiency in Working Capital Management has enabled small business enterprises to play a major role in improving firm's profitability and maximizing shareholder's value (Shaskia, 2012).

In Uganda, **A Small Enterprise** is defined as an enterprise employing 5 to 50 people; annual sales/revenue turnover of maximum Ugandan Shillings 360 million and total assets of maximum Ugandan Shillings 360 million. A **Medium Enterprise** is defined as an enterprise employing 50 to 250 people; annual sales/revenue turnover of more than Ugandan Shillings 360 million and total assets of more than Ugandan Shillings 360 million (UIA, 2008).

1.2 Statement of the Problem

Despite the significant contribution of SMEs to the Ugandan economy, the potentials of the SMEs have not been fully benefited and this poses challenge to all stakeholders in the economy (Kisaame, 2002). However, as SMEs are seen as the driving force for the promotion of an economy, they are faced with challenges and constraints that include poor performance as cited (Turyahebwa et al., 2013). SMEs in Uganda face unique problems, which affect their performance in terms of profitability and growth and hence diminish their ability to contribute effectively to sustainable development (Kazimoto, 2016).

The acute poor performance experienced by SMEs, is a result of poor Working Capital Management practices (Shaskia, 2012). A large number of business failures in Uganda have been attributed to inability of financial managers to plan and control properly the current assets and current liabilities of their respective firms (Mbaguta, 2002). Owners tend to manage these businesses themselves as a measure of reducing operational costs (Kazooba, 2006). Indeed, in some cases these problems are so challenging that SMEs are unable to address them at all, which in turn threatens their survival, growth and competitiveness. In other cases, it is the inappropriate handling of these obstacles that causes SMEs to fail. However, if the situation is not addressed, then the SMEs' contribution to the Ugandan economy is likely to be affected, and the need to examine the relationship between Working Capital Management and SME's financial performance in Uganda, provides a strong motivation for carrying out this research in detail to fill this gap.

1.3 Purpose of the study

The purpose of the study was to investigate the relationship between Working Capital Management and financial performance of SMEs in Kampala Central Division, Kampala, Uganda.

1.4 Objectives of the study

i. To examine the relationship between cash management and the financial performance of SMEs in Kampala Central Division.
ii. To investigate the relationship between Receivables management and the financial performance of SMEs in Kampala Central Division.
iii. To analyze the relationship between Inventory management and the financial performance of SMEs in Kampala Central Division.
iv. To examine the relationship between Payables management and the financial performance of SMEs in Kampala Central Division.

1.5 Research Questions

i. What is the relationship between cash management and the financial performance of SMEs in Kampala Central Division?
ii. What is the relationship between Receivables management and the financial performance of SMEs in Kampala Central Division?
iii. What is the relationship between Inventory management and the financial performance of SMEs in Kampala Central Division?
iv. What is the relationship between Payables management and the financial performance of SMEs in Kampala Central Division?

1.6 Hypotheses of the study

Hi_1: There is significant relationship between cash management and the financial performance of SMEs in Kampala Central Division.

Hi_2: There is significant relationship between Receivables management and the financial performance of SMEs in Kampala Central Division.

Hi_3: There is significant relationship between Inventory management and the financial performance of SMEs in Kampala Central Division.

Hi_4: There is significant relationship between Payables management and the financial performance of SMEs in Kampala Central Division.

1.7 Scope of the study

1.7.1 Geographical Scope

The study was conducted in Kampala Central Division, Kampala District, Uganda; which was geographical location of our study.

1.7.2 Theoretical Scope

The study was guided by the trade-off theory of Kraus & Lichtenberger (1973) which was later developed by Myers in 1984; and the Agency theory of Stephen Ross & Barry Mitnick (1973) and expanded by Jensen and Meckling in 1976.

The trade-off theory states that, it is the responsibility of business managers to make proper decisions on how much debt finance and how much equity finance to use by balancing the cost of the debt and the benefit of the debt. The agency theory is a supposition that explains a contractual relationship that exists between the principal (owner) and the agent (manager) in a business. Within a business, an agency relationship is a contract in which the principal (owner) engages an agent (manager) to perform some service on behalf of the principal (owner) which involves delegating some decision-making authority

1.8 Significance of the Study

The essence of this study cannot be over emphasized because it will help Small and Medium Scale Entities understand how effective Working Capital Management is the yardstick and bedrock of every firm, thereby, enhances the achievement of organizational objectives. Furthermore, it will guide and give a sense of direction to the entire organization in the area of channeling resources and enhancing productivity and also giving status to the organization. The results and findings of this study will be beneficial to different stakeholders as it will provide a better understanding of Working Capital Management practices (cash management, receivables management, inventory management, and payables management) and their relationship to financial performance in terms of profitability (Return on assets and Return on Equity). This study will be beneficial to academicians and future researchers who will be undertaking researches related to it. This is because it will contribute to the body of knowledge on Working Capital Management practices and its importance to Ugandan SME sector.

1.9 Operational Definitions of Key Terms

A Small Enterprise is defined as an enterprise employing between 5 to 50 people; annual sales/revenue turnover of maximum Ugandan Shillings 360 million and total assets of maximum Ugandan Shillings 360 million.

A Medium Enterprise is defined as an enterprise employing more than 50 people; annual sales/revenue turnover of more than Ugandan Shillings 360 million and total assets of more than Ugandan Shillings 360 million.

Working capital is the cash available for funding day-to-day operations of an organization. It is short term assets less by short term debts.

Management is the act of getting things done through and with others.

Working Capital Management is the planning and control of current assets and current liabilities of a firm

Assets something valuable that an entity owns, benefits from, or has use of it to generate income

Liabilities a legally binding obligation that is payable to another entity. It is a claim against the asset, arising out of past or current transactions or actions

Current Assets it is either cash or other assets that can be converted into cash within a year

Current Liabilities it is debts or obligations that are due within one year appearing on the balance sheet of the company

Cash it is legal tender or coins that can be used to exchange goods, debts or services

Receivables It is money owed by customers to a company for a good or service purchased on credit

Inventory It is goods and materials that a business holds for the purpose of resale

Payables it is money owed by a business to its suppliers for goods and services purchased on credit

Financial Performance it is measuring the outcome of a firm in monetary terms. It indicates the financial position of the firm in terms of profitability, financial efficiency and liquidity.

Profitability is the state or condition of yielding a financial profit or gain. It is usually measured by return on equity, return on assets, and earnings per share.

Return on Asset it is an indicator of how profitable a company is relative to its total assets

Return on Equity it is an indicator of how much profit each shillings invested by a shareholder generates

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter was arranged in four subsections, theoretical review, conceptual review and framework, empirical review of the related literatures, and research gaps and these were reviewed in line with the research objectives.

2.1 Theoretical Review

This study employed the trade-off theory which was initiated by Kraus and Lichtenberger in 1973 and developed by Myers in 1984; and the agency theory of Stephen Ross and Barry Mitnick in 1973 and expanded by Jensen and Meckling in 1976.

The trade-off theory explains how a company chooses to finance its business by considering two perspectives, either debt finance or equity finance. The theory states that, it is the responsibility of business managers to make proper decisions on how much debt finance and how much equity finance to use by balancing the cost of the debt and benefit of the debt (Kraus & Lichtenberger, 1973). The trade-off theory suggests that businesses seek to maintain optimal level of liquidity to balance between the benefit and cost of holding cash (Matemilola & Bany-Ariffin, 2012). The holding of optimum cash levels means that the firm can save transaction costs to raise funds, that is, current assets and meet its financial obligations, that is, current liabilities (Waithaka, 2012). The trade-off theory also suggests that the major concern of business is the effective management of the day-to-day operations in a smooth manner while increasing the shareholder's profit (Nazir & Afza, 2009). In this context, the businesses must manage their current assets and liabilities prudently. Minimization of funds tied in the current assets implies that the freed up funds can be invested hence improving financial performance of a business (Lazaridis & Tryfonidis, 2006).

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Many theories have been developed to explain the management of working capital. The agency theory also contributes to the working capital management decision. Therefore, the theory will help in trying to investigate if firms that present monitoring mechanisms of managers' actions have lower level of working capital requirement.

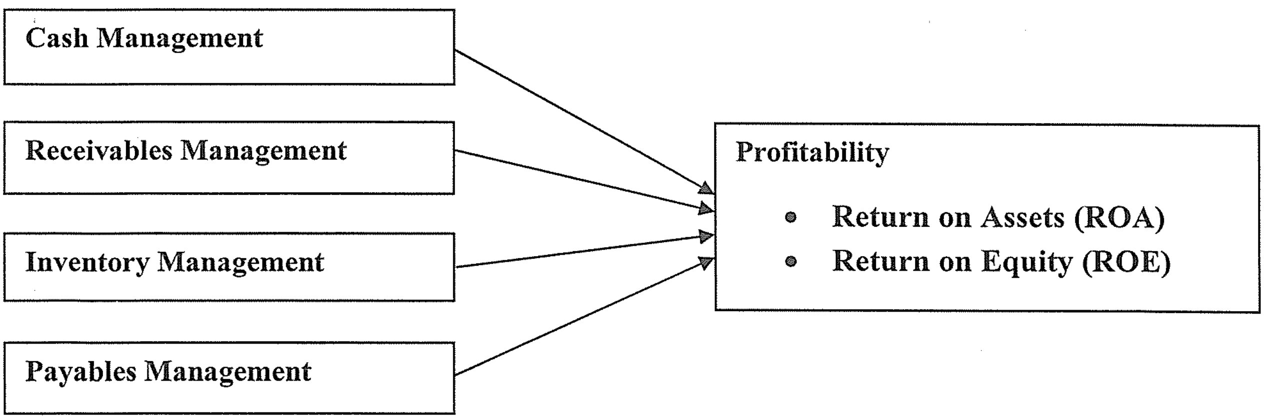
This theory relates to working capital management components from the perspective of cash management, trade receivables and inventory management. The manager is the firm's shareholders agent and makes all paramount decisions that concern the cash, receivables and the inventory of the business. His decisions have a very big impact on the shareholders' wealth this is due to the fact that if he might fail to sell to creditworthy customers resulting in reduced revenues due to low sales. This will in fact be favourable to the credit manager since he will not have to follow up on debt collection whereas the sales department will be disadvantaged. On the other hand, he might decide to sell unknowingly to un-creditworthy customers, which will result in an increase in bad debt expenses and thus reducing the shareholders' wealth. The agency theory seeks to find a balance between the agent (manager) and the principal (owner) such that the manager's decisions always have the top interests of the owners at heart.

Many theories have been developed to explain the management of working capital. The kind of working capital strategy operated will be dictated by such elements as the growth rate of the company, its size, nature of its industry and the risk elevation of the firm's management. The studies conducted by Wang (2002), Nazir and Afza (2009), and Vahid et al (2012) applied aggressive and conservative working capital policies and concluded that firms that adopt an aggressive working capital policy generate a lower rate of return than those adopting a conservative working capital policy. They argue that if the inventory levels are reduced too much, there is a risk of losing an escalation in sales. Giving less trade credit might result in a decline of sales from businesses necessitating credit that can migrate to competitors. In contrast, investing heavily in working capital may also result in higher profitability. Customers are allowed generous payment terms which stimulate demand. In contrary to that, studies done by Pais and Gama (2015) and Ismail (2016) believe that firms adopting an aggressive policy are expected to have a high level of non-current assets and modest venture in current assets, particularly with small cash balances, less level of inventories and a restrain credit to customers, so as to generate more profits. They argue that minimizing working capital investment would positively affect the profitability of the firm, by reducing the proportion of its total assets in the form of net current assets. Empirical evidence concerning working capital management and profitability in general supports the fact shrinking working capital investment is expected to result to higher profits (Jose et al., 1996). However, a successful business should adopt an optimal working capital balance between the cost and the benefit. If it has too much of working capital, then the business will incur costs like interest which can be sidestepped or these assets tied up can be invested more profitably whereas very little working capital can also have a devastating consequence. According to the study adopted by Oluoch (2014) on the impact of working capital management practices on the performance of small and medium enterprises, he applied Schumpeterian theory of profit in which he argued that the entrepreneur's survival in a competitive environment depends on their innovative ability among other factors. He says that an entrepreneur who is not innovative will not survive in the long run however favourable the conditions may be. However, this theory looks only at the innovativeness which is not the true in most cases.

2.2 Conceptual Review

Independent variable **Dependent variable**

Working Capital Management **Financial Performance**



Source: *Adapted with modification from Gitman (2009); Nyakundi et al (2016)*

Fig 2.1: *Conceptual model of the relationship between Working Capital Management and the financial performance of SMEs.*

Based on the literature under review the researcher has conceptualized the model variables as shown in figure 2.1. The model hypothesizes that efficiency in Working Capital Management practices as measured by cash management, receivables management, inventory management and payables management, have an influence on financial performance of SMEs, as proxied by the profitability in terms of Return on Assets and Return on Equity. The key concepts of this study are Working Capital Management and financial performance of SMEs. The relationship between Working Capital Management and financial performance of SMEs is that Working Capital Management is one of the strategies used by SMEs to achieve good financial performance. In this case, a good financial performance is the output of Working Capital Management system.

Working capital is the most crucial factor for maintaining profitability of businesses across any country. There has been, and there is still, growing interest in the investigation of Working Capital Management and financial performance of SMEs. The impact of Working Capital Management on the financial performance of SMEs has been the subject of numerous studies and empirical theories for many years in many different countries, as it has direct influence on profitability (Shin &Soenen, 1998; Deloof, 2003; Padachi, 2006; Lazaridis & Tryfonidis, 2007; Raheman& Nasr, 2007; Dong and Su, 2010). Working Capital Management refers to investment in **current assets** (cash and cash equivalents, short-term investments, trade and other receivables, prepaid expenses, inventories and work-in-progress) and **current liabilities** (trade payables, short-term debt and accrued liabilities) which are liquidated within one year or less and is therefore crucial for firm's day-to-day operations (Kesimli & Gunay, 2011). The net working capital is positive when current assets are greater than current liabilities (Hill et al, 2010). Working Capital Management is maintaining an optimal balance between current assets and current liabilities in a manner that eliminates the risk of inability to meet short-term obligations and avoid excessive investment in these assets (Eljelly, 2004; Mugo, 2012). Working Capital Management aims at maintaining an optimal balance between each of the working capital components, that is, cash, receivables, inventory and payables (Nazir & Afza, 2009; Okinyi, 2014). The goal of Working Capital Management therefore, is to ensure that the firm is able to continue in its operations and that it has sufficient cash flow to satisfy both maturing short-term debt and upcoming operational expenses (Brigham & Houston, 2007) and the success of any business depends on the effective management of cash, inventories, receivables and payables (Filbesck& Krueger, 2005). Cash is one of the components of the current assets of an enterprise.

Cash management refers to the collection, concentration, and disbursement of cash (Mabonga, 2014). The goal is to manage the cash balances of an enterprise in such a way as to maximize the availability of sufficient cash not invested in fixed assets or inventories for meeting its obligation. Cash collection should be sped up while cash disbursement is tightly controlled to avoid the risk of insolvency (Padachi, 2006). Pandey (2005) sees cash management as a process of planning and controlling cash flows into and out of the business, cash flows within the business, and cash balances held by a business at a point in time. According to Mansoori & Muhammad (2012), one of the standard measures of cash management is the cash conversion cycle. It refers to time-period from buying raw material, converting to finished goods, sales products, and collecting account receivables.

Receivables management is the process of making decisions relating to investment in debtors, certain investment in receivable is necessary to increase sales and profit of an enterprise. It is an arrangement between a customer and a vendor, allowing customers to buy goods from their suppliers without having to make immediate cash payments. Customers use trade credit to improve their cash flows, while vendors use trade credit to increase their sales. Trade credit can act as an effective way of allowing customers to check that the merchandise they receive is as agreed and to ensure that the services contracted are carried out, and helps firms to strengthen long-term relationships with their customers (Oluoch, 2014). The standard measure of receivables management, according to Mathuva (2010) is the Average Collection Period (ACP) which is the time taken to collect cash from customers.

Inventory management is a set of controls and guidelines that monitor the levels of inventory and determine what levels should be held, when to replenish, and the quantity of each order (Chandra, 2008). Too much stock causes additional costs in form of potential spoilage, obsolescence and storage costs, while holding too small can cause lost sales or delayed services. The standard measure of inventory conversion period (ICP), according to Deloof (2003) is the time taken to convert inventory held into sales and is used as a proxy for inventory management policy.

Payables management entails the decision to balance the benefits of trade credit against the costs associated with the credit (Van-Horne & Wachowicz, 2004). Efficient management of accounts payables will optimize the cash outflow that will ensure the firm's liquidity is not adversely affected and ultimately the profitability of the firm will not be affected in the long run (Uremadu, Egbide & Enyi, 2012). With regard to payables, the firm is responsible for paying these obligations on a timely basis. Management of payables requires the establishment of internal controls for cash disbursements to ensure that cash is disbursed only upon proper authorization of management for valid business purposes.

Financial performance is the process of measuring the results of a firm's policies and operations in monetary terms (Kabethi, 2013; Ismail, 2016). It is a subjective measure, of the degree to which financial objectives have been accomplished (Padachi, 2006). It is also used as a general measure of a firm's overall financial health over a given period of time and can be used to compare similar companies across the same industry (Maymand, 2014). Machiuka (2010) argues that the analysis of financial performance reflects the financial position of the company, the level of the competitiveness in the same sector, and a thorough knowledge about the cost and profit centres within the firm.

Financial performance of a firm has been measured, by different authors (Karaduman et al, 2004; Padachi, 2006; Garcia-Teruel & Martinez-Solano, 2007; Melicher & Leach, 2009; Enqvist et al, 2011; and Sharma & Kumar, 2011), using variables such as profitability, financial efficiency, and liquidity.

Profitability measures the extent to which a business generates a profit from the factors of production. It indicates how efficiently the management can make profit by using all the available resources, i.e. factors of production (Harward & Upton, 1961). The most useful measures of firms' profitability are Return on Assets (ROA), and Return on Equity (ROE). Return on assets (ROA) which is the net income for the year divided by the total assets (Ogoye, 2013), defines a firm's ability to utilize its assets to generate profits. Profit earned on capital invested is often a more indicative measure of financial performance than in the level of profits as a percentage of sales. Return of Equity (ROE) that is the internal performance measure of shareholder's value (Machiuka, 2010). ROE refers to how much profit a company earned compared to the total amount of shareholder equity invested or found on the balance sheet. ROE is what the shareholders see as a return to their investment. Financial efficiency means releasing cash quickly from inventory and through collections of accounts receivable, creating repayment sources that enhance credit-worthiness. Assets turnover, inventory turnover are measures of financial efficiency (Matama, (2008). The liquidity measures the ability of the business to meet financial obligations as they come due, without disrupting the normal, ongoing operations of the business (Okinyi, 2014). The current and acid test ratio are fundamental measures of liquidity.

2.3.1 Cash management and profitability of SMEs

Cash management refers to the collection, concentration, and disbursement of cash. The goal is to manage the cash balances of an enterprise in such a way as to maximize the availability of sufficient cash, not invested in fixed assets or inventories for meeting its obligation. Cash collection should be sped up while cash disbursement is tightly controlled to avoid the risk of insolvency (Padachi, 2006). The aim of cash management is to maintain adequate control over cash position to keep the firm sufficiently liquid and to use excess cash in some profitable ways (Johnson & Aggarwal (1988). Pandey (2005) sees cash management as a process of planning and controlling cash flows into and out of the business, cash flows within the business, and cash balances held by a business at a point in time. According to Mansoori and Muhammad (2012), one of the standard measures of cash management is the cash conversion cycle. It refers to time-period from buying raw material, converting to finished goods, sales products, and collecting account receivables.

According to Horne and Wachowitz (1998), cash management is very vital for small and medium enterprises whose assets are mostly composed of current assets. Efficient Cash management contributes positively to the performance of firms and their survival. Deloof (2003) said that cash management is an important source of competitive advantage of businesses. Therefore the success and failure of a business firm depends on the efficiency of cash management practices. Cash management directly affects liquidity and profitability of any firm (Raheman and Nasr, 2007). Particularly, it centres on measuring the effect of cash management on profitability just as it dwells on establishing, if any, the association between liquidity and profitability of firms. To avoid a situation of cash shortage when cash is highly needed or cash surplus when there is little or no need for cash, many companies have now embraced the idea of effective cash management. Cash management is a significant determinant of a firm's performance in terms of profitability. It thus requires expert management and planning of all inflows and outflows from an organization for the purpose of achieving profitability and good financial performance on the part of SMEs in Uganda.

Studies in Saudi Arabia, Greece, Pakistan, Nigeria, and Kenya by Eljelly (2004), Lazaridis & Tryfonidis (2006), Raheman& Nasr (2007), Falope & Ajilore (2009), and Mathuva (2010) respectively found statistically significant and negative relationship between cash management and profitability, measured through return on assets, and return on equity and the cash conversion cycle. In summary, the literatures reviewed indicate that cash management is majorly studied as part of Working Capital Management component. They further indicated that cash management is very important to generate higher rate of return and to maximize the shareholders' wealth, and the research works showed that the overall profitability and shareholders' value in the SME sector is enhanced if cash is properly managed. The studies further showed that the shorter the cash conversion cycle, the more efficiently cash is managed and ultimately the more profitable the firm as less borrowing cost is involved. On the other hand, the longer the cash conversion cycle, less cash is available and ultimately decreasing profitability due to increased borrowing cost.

2.3.2 Receivables management and profitability of SMEs

Receivables represent unpaid credit extended to customers by the business (Aminu & Zainudin, 2015). Receivables management is the process of making decisions relating to investment in debtors, certain investment in receivables is necessary to increase sales and profit of an enterprise. It is an arrangement between a customer and a vendor, allowing customers to buy goods from their suppliers without having to make immediate cash payments (Mugo, 2014). Customers use trade credit to improve their cash flows, while vendors use trade credit to increase their sales. Trade credit can act as an effective way of allowing customers to check that the merchandise they receive is as agreed and to ensure that the services contracted are carried out, and helps firms to strengthen long-term relationships with their customers (Oluoch, 2014). The standard measure of receivables management, according to Mathuva (2010) is the Average Collection Period (ACP) which is the time taken to collect cash from customers.

According to Shaskia (2012), Receivables management is an important issue for every business offering credit to its customers and the challenge for firms is to protect profit margins by reducing write-offs, cutting the cost to collect and maximizing the cash collected. Management of receivables directly affects liquidity and profitability of any firm (Raheman and Nasr, 2007) so firms should employ policies that enable them to closely monitor their receivables. A combination of shortened creditor's collection period, low levels of bad debts and a sound credit policy improves the profitability of a firm. Though it is healthy for a business to have receivables, Nyamao et al. (2012) advise SMEs to maintain an optimal level of debtors lest they suffer from costs associated with bad debts, managing credit among others.

Research studies by Deloof (2003), Laziridis & Tryfonidis (2006), Garcia-Teruel& Martinez-Solano (2007), Samiloglu & Demrigunes (2008), Mathuva (2010), Venkata et al (2013) in Belgium, Greece, Spain, turkey, Kenya and India respectively, all point out to a negative relationship between accounts receivable and firm profitability. Contradicting evidence is found by studies of Sharma & Kumar (2011) and Ikechukwu & Nwakaego (2015) in India and Nigeria who found a positive relationship between receivables management and profitability. The results showed that accounts receivables had positive and significant effect on profitability.

2.3.3 Inventory management and profitability of SMEs

Inventory management is a set of controls and guidelines that monitor the levels of inventory and determine what levels should be held, when to replenish or stock up, and the quantity to order (Chandra, 2008). The aim of Inventory management is satisfying customer needs and keeping inventory costs at a minimum level and avoids losing sales from stock-outs. An optimal level of inventory should be kept as holding too small can cause lost sales or delayed services while holding too much stock causes additional costs, obsolescence and storage costs, foregone interest, obsolescence and insurance, and damage (Gitman, 2009). Inventory is normally made up of three components, for instance raw materials, work-in-progress, and finished goods (Arnold, 2008). Costs associated with inventory management include holding costs, ordering costs, and shortage costs. Holding costs relate to costs of having physical items in stock. These include insurance, obsolescence and opportunity costs associated with having funds which could be elsewhere but are tied up in inventory. Ordering costs are costs of placing an order and receiving inven.ory. These include determining how much is needed, preparing invoices, transport costs and the cost of inspecting goods. Shortage costs result when demand exceeds the supply of inventory on hand. These costs include opportunity costs of making a sale, loss of customer goodwill, late charges and similar costs. The standard measure of inventory conversion period (ICP), according to Deloof (2003) is the time taken to convert inventory held into sales and is used as a proxy for inventory management policy.

According to Peterson & Joyce (2007), ROA can be maximized by either reducing the material cost or reducing the current assets tied up in the inventory or by increasing profits. Peterson and Joyce (2007), maintain that inventory management can make a direct contribution in increasing profitability by deciding inventory norms and through control systems. Inventory turnover can be maximized which in turn will maximize current assets turnover and ROA (Pandey, 2005).

Studies done by Deloof (2003), Eneje et al (2012), Sekeroglu & Altan (2014), Kwadwo & Vipulesh (2015), in Belgium, Nigeria, Turkey, Ghana & India respectively have found statistically that there is a positive relationship between inventory management and profitability of firms measured through inventory turnover and return on assets and net profit margin. These results were contradicted by studies done by Raheman & Nasr (2007), Cannon (2008), Jamal et al (2016), in Pakistan, USA & Malaysia, who stated that there is a negative relationship between inventory management and firm's profitability by using inventory turnover, inventory handling and gross profit margin and ROA.

In summary, the literatures reviewed indicate that inventory management is majorly studied as part of Working Capital Management component. They further indicated that inventory management is very important factor to be considered in enhancing and boosting performance of SMEs. The studies recommended to train employees from time to time to update their knowledge and skills in modern inventory control techniques and also to improve inventory management practices that can lead to better performance in terms of higher rates of return and shareholders' wealth, and the research works showed that the overall profitability and shareholders' value in the SME sector is enhanced if inventory is properly managed.

2.3.4 Payables Management and Profitability of SMEs

Accounts payable are suppliers whose invoices for goods or services have been processed but not yet been paid. Payables management entails the decision to balance the benefits of trade credit against the costs associated with the credit (Van-Horne & Wachowicz, 2008). Efficient management of accounts payables will optimize the cash outflow that will ensure the firm's liquidity is not adversely affected and ultimately the profitability of the firm will not be affected in the long run (Uremadu et al, 2012). With regard to payables, the firm is responsible for paying these obligations on a timely basis. Management of payables requires the establishment of internal controls for cash disbursements to ensure that cash is disbursed only upon proper authorization of management for valid business purposes.

Payables management is a very important for SMEs and will contribute to the profitability and survival of firms if it is managed adequately. Accounts payable ratio (AP) represents the rate firms pay to their suppliers. It is one of the major sources of secured short-term financing (Gitman, 2009). Wilner (2000) argues that reducing supplier financing, by making quick payment, will result in substantial price deduction. Gitman (2009) claim that the aim of Payables Management is to prolong the time of payment as long as possible without damaging its credit rating.

Research studies made by Deloof (2003), Karaduman et al (2010), Lazaridis and Tryfonidis (2006), Padachi (2006), Enqvist et al (2009), Sharma & Kumar (2011), Eljelly (2014), and Mengesha (2014) in Belgium, Turkey, Greece, Mauritius, Finland, India, Saudi Arabia and Ethiopia respectively showed a negative relationship between ROA and Payables Management. These results are not in line with researches conducted by Raheman& Nasr (2007), Nyabwaga et al (2012), Wanjiku (2013) who established a positive relationship between ROA and the Payables management.

2.4 Related Studies

Study conducted by Kazimoto (2016) in Uganda employed quantitative approaches with descriptive and correlation designs. The study applied simple random techniques and 63 respondents were selected to respond to questions administered for data collection. The study concluded that the level of working capital management was low as well and the level of financial performance of selected companies was also low. Result reveals that there is a positive and moderate significant relationship between Working Capital Management and financial performance of the selected companies in Uganda.

Deloof (2003) investigated a sample of 1,009 Belgian firms and found a significant negative relation between profitability and the individual components of working capital: the number of day's accounts receivable, inventories and accounts payable. According to Deloof (2003) the negative relation between profitability and the number of day's accounts receivable and inventories suggest that managers can create shareholder value by reducing the number of day's accounts receivable and inventories to an optimal minimum. Deloof (2003) argues that the negative relation between profitability and accounts payable is due to firms delay payment of their bills for survival purposes.

Padachi (2006) conducted a study on small Mauritian manufacturing firms, during 1998 to 2003. Padachi (2006) used return on total assets as measure for profitability, and found that by lengthening the number of days for accounts payable, the profitability can be affected or impaired because of the cost of discount for paying early to suppliers. When sales are less, firms delay the payment to creditors in order to survive. The researcher found that the number of days in accounts receivable has a significant relation with return on total assets which implies that an increase of accounts receivable with one day will result in a lower profitability.

Eljelly (2004) researched on the relationship between profitability and WCM using 27 Saudi companies from three non-financial sectors for the period 1996-2000. He found that working capital management components are significant and have negative relationship with profitability.

Khan (2012) carried out a research to investigate the effect of working capital management on profitability. He used a sample of 92 Pakistani firms from textile sector for the period 2001 to 2008. The findings of the study show an existence of a moderate risk-return trade off in between profitability and liquidity. Also, working capital management has significant impact on profitability regarding to textile sector of Pakistan. This is not in line with the findings of Raheman & Nasr (2007) which established a significant and negative relationship between profitability and all working capital management components based on a study of ninety-four (94) listed firms in Pakistan.

Nyabwaga et al (2012) studied the effect of working capital management practices on the financial performance of small scale enterprises in Kisii South District using a sample of 113 SMEs. They used Pearson's correlation co-efficients and multiple regression analysis techniques to analyze data. The findings of the study were that working capital management practices were low amongst SMEs as majority had not adopted formal working capital routines and their financial performance was positively related to efficiency of cash management, efficiency of receivables management, and efficiency of inventory management.

Sharma & Kumar (2011) conducted a research on the effect of working capital management on profitability of a sample of 263 Indian firms listed at Bombay stock exchange from 2000 to 2008, using multiple regressions. The results revealed that working capital management practices and profitability are positively correlated in Indian firms.

2.5 Research Gaps

Although studies on working capital management have been carried out by various scholars, the studies do not provide clear-cut direction of the relationship between working capital and firm's performance. Further examination of these studies reveals that there is little empirical evidence of the impact of working capital management and the firm's performance in case of SMEs. Therefore, the present study is an attempt to fill this gap and to estimate the relationship between working capital management and performance of SMEs in Central Division, Kampala.

This study is based on trade-off theory and agency theory. The trade-off theory suggests that businesses seek to maintain an optimal level of liquidity to balance between the benefit and cost of holding cash, while agency theory assumes that there is a contractual relationship between the principal and the agent which controls the conflict of interest. The principal employs an expert to monitor the activities. The theory also recognizes the incomplete information about relationship. However, in the review of the agency theory, the following gaps can be observed: it does not consider management practices that can sustain and enhance financial performance and finally, it does not consider the effective management styles (transformational, democratic and situational) that drive the organization to realize its goals.

Several studies on working capital management and financial performance have been carried out in different areas across the world. However, most studies carried out did not give a great attention to Small and Medium Enterprises (Nyakundi et al., 2016; Wanjiku, 2013) and these studies suggested further research in the SME sector which this study is trying to fill. Much as studies on working capital management and financial performance are in existence, there are still gaps that this study is trying to fill. Studies carried out on SMEs did not give attention to the cash management as a component of working capital management and this study however will cater for this with the objective number one of examining the relationship between working capital and financial performance of SMEs in Kampala Central Division.

With regard to financial performance, studies carried were only considering gross profit margins, net profit margins, and liquidity as the measures of financial performance but this study shows that there are other measures of financial performance like return on asset and return on equity that this study is considering as the measures of financial performance as evidenced in the literature review.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

This chapter entailed the research design, area of study, target population, sample size, sampling procedure, sources of data, data collection instruments, validity and reliability of the instruments, ethical considerations and finally, the anticipated limitations of study. The section further provided the methodology that was used to obtain the perspectives of the respondents towards the research questions, hypotheses, independent and dependent variables, for data collection and a statistical analysis plan.

3.2 Research design

The research adopted quantitative approach with descriptive and correlation designs for purposes of relating the independent variable (Working capital management) to the dependent variable (Financial performance of SMEs). Opinions of the people employed in the SMEs were sought with the use of structured questionnaires. SMEs are composed of many sectors and the researcher cannot cover all of those sectors due to lack of time and other resource constraints. The quantitative method used was based on variables measured with numbers and analyzed using descriptive statistics to investigate people's perceptions and opinions on the management of working capital and the SMEs profitability.

3.3 Area of the study

The study was conducted in Kampala Central, Kampala district, Uganda.

3.4 The population of the study

The target population was comprised of 2,211 SMEs in the Central division of Kampala district. The researcher targeted respondents of SMEs from the trade sector. The population was segregated into several mutually exclusive subpopulations herein referred to as categories. These categories were managers and owner-managers from the trade sector.

Source: *KCCA, Kampala Central Division, Department of Trade (2017).*

3.5 Sample Size and sampling procedure

Out of a population of 2,211 SMEs, the researcher used a sample of 327 SMEs. This is in accordance with the rule of the Krejcie& Morgan (1970). The table is in the appendix B.

Krejcie& Morgan (1970) have given the following formula to arrive at the desired sample size::

$$S = \frac{X^2 NP(1-P)}{d^2(N-1)+X^2 P(1-P)} \ldots\ldots\ldots\ldots\ldots\ldots (3.1)$$

S = Required Sample size =?

X = Z value =1.96 for 95% confidence level

N = Population size =2,211

P = Population proportion (expressed as decimal) assumed to be 0.5 or 50%

d = Degree of accuracy (5%), it is a margin of error or the significance level

$$S = \frac{(1.96)^2 * 2{,}211 * 0.5(1-0.5)}{((0.05)^2 * (2{,}211-1))+(1.96)^2 * 0.5(1-0.5)}$$

$$S = \frac{3.8416 * 2{,}211 * 0.5 * 0.5}{(0.0025 * 2{,}210)+(3.8416 * 0.5 * 0.5)}$$

$$S = \frac{2{,}123.44}{6.4854}$$

$$S = 327$$

The research also employed a stratified random sampling in selecting respondents.

The research applied proportionate stratification that is based on the stratum's share of the total population to come up with the sample in each stratum.

3.6 Data types and collection methods

3.6.1 Primary source of data

To obtain primary data from respondents, the researcher employed self-scoring questionnaire. The self-scoring questionnaire was used to ascertain the respondent's perceptions. The questions were simply worked to avoid obscure meaning and to encourage independence in making the response. The respondents were business managers, and owner-managers.

3.6.2 Research instruments

The study used self administered questionnaire as data collection instruments. Questionnaire; in this case self administered questionnaires were designed to be used by people who can read and write and these set of questions at the same time acted as response schedule. Close ended questionnaires were used because they enable the researcher to obtain full information concerning the study variables without biasness. A set of questions were given to each respondent which were filled in by the respondent. The questionnaire were designed according to the objectives of the study and the study variables and responses were anchored on a five (5) point Likert scale ranging from 1 (Strongly disagree) to 5 (Strongly agree). Section A of the questionnaires was used to collect data on working capital management while section B was used to gather data on financial performance.

3.7 Data testing (Validity and Reliability)

3.7.1 Validity of the Instrument

The research instruments that the researcher used were questionnaires. Questionnaires were cross examined for approval by the supervisor to ensure that the information they would generate is appropriate and reliable. The researcher carried out a pre-testof the questionnaire before using it in the research. Content validity was established using expert judgment method provided by Amin (2005) who suggested that content validity can be calculated by finding the content validity index (CVI) which should not be less than 0.7. The content validity (CV) method was calculated by using the formula below:

$$CVI = \frac{Number of Items declared valid}{\text{Total Number of Items}} \ldots\ldots\ldots\ldots\ldots\ldots\ldots (3.2)$$

$$CVI = \frac{30}{37} = 0.81$$

Since the content validity index (CVI) of the instrument is greater than 0.7, the instrument is irrefutably valid as well as ready for data collection.

3.7.2. Reliability of the Instruments

To ensure reliability, the researcher conducted a pilot test and the questionnaire was given to 33 respondents who were part of the target populationand after two weeks, the same questionnaire was given to the same people and the Cronbach's Alpha reliability coefficient which ranges in value from 0 to 1 was computed using SPSS. The commonly accepted rule of thumb of this approach is that an alpha (α) of 0.7 indicates acceptable reliability, and 0.8 or higher indicates good reliability (Mohsen &Dennick, 2011). Therefore the higher the score the more reliable generated scale is. However, to test for reliability Cronbach's alpha was computed using SPSS (statistical package for social sciences), and the following result was obtained:

Table**3.1** Reliability statistics

Reliability Statistics	
Cronbach's Alpha	**N of Items**
0.86	**36**

The research instrument was declared reliable since the Cronbach's Alpha value was above 0.7 which is the minimum Cronbach's Alpha value required to declare an instrument reliable.

3.8 Data Analysis

3.8.1 Descriptive Data Analysis

The data gathered was analyzed and presented using descriptive statistics. Primary data was captured and processed using Statistical Package for Social Sciences (SPSS), windows and Microsoft Excel. SPSS is a well-used computer package in research to calculate effectiveness of study and programmes by performing a variety of statistical analyses and procedures (Taylor 1997). After the questionnaires were returned, the researcher edited all questionnaires to ensure legibility and accuracy. Basing on the 5 points scale suggested by Likert (1932) i.e. Strongly agree (5); Agree (4); Not sure (3); Disagree (2); and Strongly disagree (1), the following mean range was used to arrive at the mean of individual indicators and interpretation:

Table3.2: Working capital Management

Mean Range	Response mode	Interpretation
4.2 – 5.0	Strongly agree	Very Satisfactory
3.4 - 4.2	Agree	Satisfactory
2.6 - 3.4	Not sure	Fairly Satisfactory
1.8 - 2.6	Disagree	Unsatisfactory
1.0 - 1.8	Strongly disagree	Very Unsatisfactory

Table 3.3: Profitability of Small and Medium Enterprise

Mean Range	Response mode	Interpretation
4.2 – 5.0	Strongly agree	Very High
3.4 - 4.2	Agree	High
2.6 - 3.4	Not sure	Moderate
1.8 - 2.6	Disagree	Low
1.0 - 1.8	Strongly dısagree	Very Low

3.8.2 Inferential Data Analysis

This involved analysing the relationship between working capital management and the financial performance of SMEs. To examine the relationship between the independent and dependent variables, at 0.05 level of significance Pearson's correlation coefficient was used and this helped to measure the degree and direction of relationship between the variables. Values of correlation between +1.0 and -1.0 reflect positive and negative relationship respectively. The value 0 will reflect no relationship, and the value obtained will be compared with the critical value from the Pearson's correlation table (Amin, 2005). If the P-value is smaller than the significance level of 0.05, the researcher accepts the alternative hypothesis 'Hi' and rejects the null hypothesis 'H_o'. Then the researcher concludes that there is significant relationship between the independent and dependent variables, at the 0.05 significance level. If the P-value is larger than the significance level of 0.05, the researcher rejects the alterative hypothesis 'Hi' and accepts the null hypothesis 'H_o'. Then the researcher concludes that there is no significant relationship between the independent and the dependent variables, at the 0.05 significance level.

For the computation of the Pearson's Linear Correlation Coefficient the following formula was used:

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2}\sqrt{n\sum y^2 - (\sum y)^2}} \text{-------------(3.3)}$$

n is the sample size, x = working capital management; and y =financial performance

Furthermore, for investigating the effect of working capital management on the financial performance of SMEs in Kampala Central Division, regression analysis was employed.

Y= a + bX---3.4)

Y= the independent variable, X= the dependent variable, a= the y-intercept, b= the slope of the regression line

3.9 Ethical consideration

Consent

Consent involves the procedure by which an individual may choose whether or not to participate in a study. The researcher ensured that participants have a complete understanding of the purpose and methods to be used in the study, the risks involved, and the demands placed upon them as a participant. The participants were informed that they have the right to withdraw from the study at any time

Confidentiality

The researcher explained to the respondents that information provided about this research study will be kept confidential and for academic purposes only. This was ensured by not inquiring the respondents to write their names but the researcher used code numbers to describe the respondents.

Deception

Research deception involves an intentional misrepresentation of facts related to the purpose, nature, or consequences of an investigation. In this context, the researcher had fully informed participants about important aspects of the study to avoid omissions and commissions as part or all of the information not to be withheld.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.0 Introduction

Under this chapter data collected from the field was presented, analyzed and interpreted. Data analysis and interpretation were based on the research objectives. Below are the data presentations and analysis of research findings;

4.1 Response Rate

Response rate also known as completion rate or return rate in research refers to the number of people who answered the questionnaires divided by the number of people in the sample. It is usually expressed in the form of a percentage. A low response rate can give rise to sampling bias if the non-response is unequal among the participants regarding the outcome. In this study, the sample size was 327 respondents but the study managed to access 320 respondents, i.e. 98% of the response was retrieved.

4.2 Descriptive Statistics of Working Capital Management

The independent variable in this study was working capital management, this variable (IV) was broken into four constructs and these were; cash management (with five questions), inventory management (with seven questions), receivables management (with four questions) and payables management (with three questions). Each of these questions was based on a five point Likert scale whereby respondents were asked to rate the working capital management by indicating the extent to which they agree or disagree with each question.

4.2.1 Descriptive Statistics of Cash Management

Table 4.1: Descriptive Statistics of Cash Management

	N	Min.	Max.	Mean	Std. Dev.
Cash Management enables the business to have sufficient stocks as per customers' demands	320	2	5	4.06	.836
Cash management in my firm enables payments of my bills on required time	320	1	5	3.90	1.031
Cash management in my firm enables me to get preferential treatment from my suppliers through cash discounts	320	1	5	3.58	1.155
Cash management in my firm ensures that any excess cash is adequately invested	320	1	5	3.54	1.241
Cash management in my firm enables the business to have increased sales	320	1	5	2.5	1.235
Average Mean				**3.5**	

Source:*Primary Data, 2018*

Results in Table 4.1 indicate that cash management among SMEs in Kampala Central Division was rated satisfactory and this is indicated by the overall mean of 3.5, implying that the owners of SMEs in Kampala Central Division fairly manage their cash well. Respondents were asked whether cash management had enabled firms to have sufficient stocks as per customers' demands and most of them were in total agreement with the question as they were asked to answer depending on their level of agreement ranging from strongly disagree to strongly agree and the computed mean value is 4.06 which is within the second mean range and tending to the rank 4 (Agree) meaning that cash management had enabled firms to have sufficient stocks as per customers' demands satisfactorily because it is within the mean range of 3.4-4.2.

Respondents were also asked whether cash management had enabled firms to pay bills on time and majority of them were in agreement with the question and the response was satisfactory and this is indicated by the computed mean value (mean=3.9) since it is within the mean range of 3.4-4.2, implying that cash management had satisfactorily enabled firms to pay bills on time. Respondents were also asked whether cash management had enabled them to get preferential treatment from their suppliers through cash discounts and the majority were in agreement with the question and the rate was satisfactory and this is indicated by the mean computed (mean=3.58) since it is within the mean range of 3.4-4.2. Hence, it can be said that cash management had satisfactorily enabled firms to get preferential treatment from their suppliers through cash discounts. Respondents were also asked that cash management had ensured that any excess cash is adequately invested and the majority were in agreement and the response was satisfactory (mean=3.54). However, cash management had not enabled firms to have increased sales, and this is clearly indicated by the mean value (mean=2.5) since it is not in agreement with the question and mean value computed falls in the range between 1.8-2.6 and in accordance with the mean interpretation scale given in Table 3.8, it tends to the second lowest rank 2 (disagree) which makes the response unsatisfactory.

4.2.2 Descriptive Statistics of Receivables Management

Table 4.2: Descriptive Statistics of Receivables Management

	N	Min.	Max.	Mean	Std. Dev.
Receivables of this business are properly managed	320	1	5	3.95	1.227
There is proper review and follow up of receivables in this business	320	1	5	3.89	1.079
There is a limit in the amount of receivables in this business	320	1	5	3.50	1.348
Proper measures are taken if there is delay in collection receivables	320	1	5	3.47	1.074
Average Mean				**3.69**	

Source: *Primary Data, 2018*

Results in Table 4.2, show that receivables management among SMEs in Kampala Central Division was rated satisfactory and this is indicated by the overall mean of 3.69, implying that the owners of SMEs in Kampala Central Division manage their receivables well. Respondents were asked whether receivables of this business were properly managed and most of them were in total agreement with the question and the computed mean value (mean=3.95) is within the range of 3.4-4.2, meaning that receivables were properly managed and the response rate was satisfactory. Respondents were also asked whether there was proper review and follow up of receivables in this business and the response given was satisfactory with respect to the mean value computed (mean=3.89) and interpreted as agreed by the majority of the respondents. Results still show that there was a limit in the amount of receivables in their business (mean=3.5); respondents also agreed that proper measures were taken when there is a delay in collection of receivables (mean=3.47). However, this clearly interprets that majority of the respondents agreed that the receivables management among SMEs in Kampala Central Division was satisfactory since the mean values are all in the range of 3.4-4.2 which is the second highest rank 4 (Agree).

4.2.3 Descriptive Statistics of Inventory Management

Table 4.3: Descriptive Statistics of Inventory Management

	N	Min.	Max.	Mean	Std. Dev.
Inventory management in this business is efficient and effective	320	2	5	4.17	.666
Optimal order and replenishment frequency are made on a regular basis as part of a continuous improvement process	320	1	5	4.05	.912
Management reviews the reconciliation of physical inventory counts to the inventory records	320	2	5	3.97	.680
Stock levels are reviewed on a regular basis to ensure they are up to date	320	1	5	3.67	.915
It takes a long period to sell our inventories or stocks to our customers	320	1	5	3.20	1.371
Adequate provision is made for obsolete and inactive items in inventories	320	1	5	2.55	1.102
Internal controls appear adequate for the inventory system	320	1	5	2.50	1.150
Average Mean				**3.44**	

Source:*Primary Data, 2018*

Results in table 4.3 indicate that inventory management among SMEs in Kampala Central Division, Uganda was rated satisfactory and this was indicated by the overall mean of 3.44, implying that the owners of SMEs in Kampala Central Division, Uganda fairly manage their inventory well. With respect to Table 4.10; results indicate that inventory management was rated high and this was indicated by the average mean (mean=3.44), implying that inventory management is fairly done well by the SMEs in Kampala Central Division. Results also indicate that inventory management is efficient and effective (mean=4.17), optimal order and replenishment frequency are made on a regular basis as part of a continuous improvement process (mean=4.05), management reviews the reconciliation of physical inventory counts to the inventory records (mean=3.97), stock levels are reviewed on a regular basis to ensure they are up to date (mean=3.67). All those responses were satisfactory and the respective means computed were in the range of 3.4-4.2 which tend to the second highest rank 4 (Agree). Respondents were also asked whether internal controls appear adequate for the inventory system, and whether adequate provision is made for obsolete and inactive items in inventories, however respondents disagreed and this implies that SMEs in Kampala Central Division had not considered internal controls adequate for the inventory system (mean=2.5), and also results indicate that adequate provision is not made for obsolete and inactive items in inventories (mean=2.55) and this is because these respective means computed are in the range of 1.8-2.6.

4.2.4 Descriptive Statistics of Payables Management

Table 4.4: Descriptive Statistics of Payables Management

	N	Min.	Max.	Mean	Std. Dev.
Our creditors are paid on time in order to earn trust from them	320	2	5	4.13	.632
There is proper review and follow up of payables in this business	320	1	5	3.78	.675
There is proper management of accounts payables in our business	320	1	5	3.61	1.056
Average Mean				**3.84**	

Source: *Primary Data, 2018*

Results in Table 4.4, respondents were asked whether creditors were paid on time to earn trust from them and majority of the respondents were in total agreement with the question and the mean value (mean=4.13) is within the range of 3.4-4.2, meaning that creditors were paid on time and the response rate was satisfactory. Respondents were also asked whether there was proper review and follow up of payables in their business and the response given was satisfactory with respect to the mean value computed (mean=3.78) and interpreted as agreed by the majority of the respondents. Results still show that there was proper management of payables in business (mean=3.61). However, this clearly states that majority of the respondents agreed that the payables management among SMEs in Kampala Central Division was satisfactory since the mean values are all in the range of 3.4-4.2 which is the second highest rank 4 (Agree).

4.3 Descriptive Statistics of Financial Performance

Financial performance is the dependent variable in this study and measured with profitability which was broken into two constructs and these are; ROA (with five questions) and ROE (with four questions). Each of these questions was based on a five point Likert scale and respondents were asked to rate profitability by indicating the extent to which they agree or disagree with each question, their responses were analyzed using SPSS and summarized using means and standard deviations as indicated in tables below:

Table 4.5: Descriptive Statistics of Financial Performance

Return On Assets (ROA)	N	**Min.**	**Max.**	**Mean**	**Std. Dev.**
The net operating assets sufficiently support the daily operations	320	2	5	3.83	.984
There has been a gain in profits on the capital employed by the business	320	1	5	3.57	1.214
The ROA is higher than the costs of operation in the previous periods	320	1	5	3.54	1.211
This business has expanded because of high ROA	320	1	5	2.55	1.162
The current assets are generative of more profits in your business	320	1	5	2.50	1.150
Average Mean for ROA					**3.2**
Return On Equity (ROE)	N	**Min.**	**Max.**	**Mean**	**Std. Dev.**
The ROE is a financial measure of our business	320	1	5	3.71	1.222
The state of capital in this business is steadily growing	320	1	5	3.56	1.326
Owners of this business receive relatively high returns on equity	320	1	5	2.99	1.174
The net profit margins of this business are high	320	1	5	2.43	1.075
Average Mean for ROE					**3.17**
Overall Mean for Financial Performance					**3.19**

Source: *Primary Data, 2018*

Results in table 4.5 show that the profitability is moderate and this is indicated by the overall mean of 3.19, which implies that SMEs in Kampala Central Division have resources which can make them financially perform moderately. With respect to returns on assets; results in table 4.5 indicate that this construct was rated moderate and is fairly satisfactory and this was indicated by the average mean of 3.2. Still results indicate that the net operating assets sufficiently support the daily operations (mean=3.83) which shows that respondents rated this item high; respondents were also asked whether there has been a gain in profits on the capital employed by the business and results show that respondents rated high (mean=3.57) meaning that there has been a gain in profits on the capital employed by the business; the results also indicate that ROA is higher than the costs of operation in the previous periods (mean=3.54). However, businesses have not made expansion even though they got moderate returns (mean=2.55) and the current assets didn't generate more profits (mean=2.5). Hence, this implies that SMEs in Kampala Central have financially performed moderately in terms of return on assets.

With respect to returns on equity; results in table 4.5 indicate that this construct was rated fairly satisfactory and this was indicated by the average mean of 3.17. Still results indicate that the ROE is a financial measure of our business (mean=3.71); the state of invested capital in the business is steadily growing (mean=3.56). However, owners of the business don't receive relatively high returns (mean=2.99) and the net profit margins of the business weren't high (mean=2.43).

4.4 Relationship between Cash Management and Financial Performance

Table 4.6: Correlations of cash management and financial performance

		Cash Management	**Financial Performance**
Cash Management	Pearson Correlation	1	.170**
	Sig. (2-tailed)		.002
	N	**320**	**320**
Financial Performance	Pearson Correlation	.170**	1
	Sig. (2-tailed)	.002	
	N	**320**	**320**
**. Correlation is significant at the 0.01 level (2-tailed).			

Source: *Primary Data, 2018*

In order to examine the relationship between cash management and financial performance of SMEs in Kampala Central Division, Pearson's Linear Correlation Coefficient was computed as shown by the results in Table 4.6. The results reveal that there is a significant and positive (r=0.170**, N=320, p=0.002<0.01) relationship between cash management and financial performance. This means that cash management is an important factor as it determines the level of financial performance and good financial performance is the result of efficient cash management (Horne &Wachowitz, 1998). However, the alternative hypothesis which was previously stated that there is significant relationship between cash management and financial performance of SMEs in Kampala Central Division can be accepted and null hypothesis be rejected by concluding that there is a significant and positive relationship between cash management and financial performance. The relationship is significant because the probability value (0.002) is less than 0.01<0.05. Hence, efficient cash management contributes positively to the profitability of firms and their survival (Deloof, 2003)

4.5 Relationship between Receivables Management and Financial Performance

Table 4.7: Correlations of Receivables Management and Financial Performance

		Receivables Management	Financial Performance
Receivables Management	Pearson Correlation	1	0.129
	Sig. (2-tailed)		0.021
	N	**320**	**320**
Financial Performance	Pearson Correlation	0.129	1
	Sig. (2-tailed)	0.021	
	N	**320**	**320**

Source: *Primary Data, 2018*

In order to examine the relationship between receivables management and financial performance, Pearson's Linear Correlation Coefficient was used and the results in Table 4.7 reveal that there is significant (r = 0.129*, N =320, p =0.021<0.05) and positive relationship between receivables management and financial performance. Therefore, it can be said that for a good financial performance, receivables should be properly managed. However, with regards to the alternative hypothesis number 2, it can confidently be accepted and state that there is significant relationship between receivables management and financial performance of SMEs in Kampala Central Division. The relationship is significant because the p-value (p =0.021) is less than 0.05.

4.6 Relationship between Inventory Management and Financial Performance

Table 4.8: Correlations of Inventory Management and Financial Performance

		Inventory Management	**Financial Performance**
Inventory Management	Pearson Correlation	1	0.114
	Sig. (2tailed)		0.042
	N	**320**	**320**
Financial Performance	Pearson Correlation	0.114	1
	Sig. (2tailed)	0.042	
	N	**320**	**320**
*** Correlation is significant at the level of 0.05 (2-tailed)			

Source: *Primary Data, 2018*

In order to examine the relationship between inventory management and financial performance, Pearson's Linear Correlation Coefficient was used and the results in Table 4.8 reveal that there is a significant ($r = 0.114^*$, $N = 320$, $p = 0.042 < 0.05$) and positive relationship between inventory management and financial performance. This means that inventory management and financial performance move on same directions and it can be said that for there to be good financial performance, inventory management should be properly maintained. However, with regards to the alternative hypothesis number 3, it can confidently be accepted and state that there is a significant relationship between inventory management and financial performance of SMEs in Kampala Central Division. The relationship is significant because the p-value ($p = 0.042$) is < 0.05.

4.7 Relationship between Payables Management and Financial Performance

Table 4.9: Correlations of Payables Management and Financial Performance

		Payables Management	Financial Performance
Payables Management	Pearson Correlation	1	-.085
	Sig. (2-tailed)		.131
	N	**320**	**320**
Financial Performance	Pearson Correlation	-.085	1
	Sig. (2-tailed)	.131	
	N	**320**	**320**

Source: *Primary Data, 2018*

In order to examine the relationship between payables management and financial performance, Pearson's Linear Correlation Coefficient was used and the results in Table 4.9 reveal that there is negative and insignificant ($r = -0.085^*$, $N = 320$, $p = 0.131 > 0.05$) relationship between payables management and financial performance. This means that payables management and financial performance move on opposite directions and it can be said that for there to be good financial performance, payables should be properly managed. However, with regards to the alternative hypothesis number 4, it can confidently be rejected and state that there is no significant relationship between payables management and financial performance of SMEs in Kampala Central Division. The relationship is not significant because the p-value ($p = 0.131$) is greater than 0.05.

4.8 Effects of working capital management on financial performance (Purpose)

The purpose of this study was to examine the effects of working capital management on financial performance of SMEs in Kampala Central Division. In order to perform this regression analysis was used so as to measure the direction of the relationship between the variables and this was computed using SPSS (statistical package for social sciences) version 20.0 for windows and the followings are the results obtained.

Table 4.10 Effects of working capital management on financial performance

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	**.560**	**.314**	**.311**	**.417**

Source: *Primary Data, 2018*

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11.595	1	11.595	65.51	0.003
	Residual	56.286	318	.177		
	Total	**67.881**	**319**			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Working Capital Management

Source: *Primary Data, 2018*

Coefficients						
Model		Un-standardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.736	.287		9.62	0.000
	Working Capital Management	0.128	0.079	0.560	1.62	0.003

Source: *Primary Data, 2018*

Regression analysis results in the Model Summary table revealed that working capital management accounted for 31.4% on profitability of SMEs in Kampala Central Division and this was indicated by r-squared of 0.314 implying that working capital management contributes to the profitability of SMEs in Kampala Central Division at 31.4%.

The ANOVA table indicated that working capital management significantly affects the profitability and this was indicated by the F-value= 65.51 and Sig-value=0.003, since the sig.

value (0.003) was less than 0.05 and which is the maximum level of significance required to declare a significant effect. This implies that working capital management contributes positively to the profitability of SMEs in Kampala Central Division. Still this implied that high levels of working capital management can improve the level of profitability and poor working capital management can lower the level of profitability.

The coefficients table indicated that considering the standard error, working capital management significantly influences the profitability of SMEs in Kampala Central Division (β=0.560, Sig=0.003).

Testing for hypothesis

The hypothesis was accepted since the significant value was found to be less than 0.05 (Sig=0.003).

The results on coefficients table indicate that there is a significant positive relationship (β=0.560) between working capital management and financial performance of SMEs in Kampala Central Division, Kampala-Uganda.

CHAPTER FIVE

DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter contains discussion of the findings, conclusion, and recommendations. The major findings of this study are based on working capital management and financial performance of SMEs in Kampala Central Division basing on the variables under study. The conclusion is made and further recommendations are provided, and suggested areas that need further research following the study objectives.

5.1 Discussion

This study aimed at examining the effect of working capital management on financial performance of SMEs in Kampala Central Division. Four specific objectives guided this study and these were; (i) to examine the relationship between cash management and the financial performance of SMEs in Kampala Central Division (ii) to investigate the relationship between receivables management and the financial performance of SMEs in Kampala Central Division (iii) to analyze the relationship between inventory management and the financial performance of SMEs in Kampala Central Division, and (iv) to examine the relationship between payables management and the financial performance of SMEs in Kampala Central Division.

Since the working capital constitute a major share and significant position, its management plays a pivotal role in the efficient functioning of SMEs. Most SMEs for their working capital funds depend on short term financing like cash, bank loans, over drafts etc. However, given their reliance on short term funds, it has long been recognized that efficient management of working capital is crucial for the survival and growth of SMEs (Srinivas&Deogratias, 2013).

From the findings of this study it indicates that there is a positive and significant relationship between working capital management and financial performance of SMEs in Kampala Central Division. This means that for a good financial performance, working capital components should be properly managed due to the reason that working capital components determine the level of financial performance and whenever working capital components are improved and properly managed, then the financial performance of SMEs increases. However, working capital management practices contribute positively to the profitability of

SMEs in Kampala Central Division. Working capital management practices influence profitability of SMEs when maintained at optimal level by balancing the benefits and costs associated with it.

5.1.1 Objective One: The relationship between Cash Management and the Financial Performance of SMEs

The findings of this study indicate that cash management is an important factor as it determines the level of financial performance and good financial performance is the result of efficient cash management. This finding is in line with Deloof (2003) who noted that efficient cash management contributes positively to the profitability of firms and their survival.

Studies of Gill (2010) and Sharma & Kumar (2011) measured the relationship between profitability and cash conversion cycle, examined 88 firms between 2005 and 2007 and 263 firms in the Bombay Stock Exchange (BSE) 500 have been analyzed between 2000 and 2008 in USA and India respectively. They found that the relationship between cash management and profitability is positive, which is also in total agreement with the findings of this research study.

The findings of this study's objective one which states that cash management is positively correlated with financial performance negated or contradicted several studies made in Saudi Arabia, Greece, Pakistan, Nigeria, Kenya and Norway by Eljelly (2004), Lazaridis&Tryfonidis (2006), Raheman& Nasr (2007), Falope&Ajilore (2009), Mathuva (2010), Lyngstadas& Berg, (2016) respectively. These studies found statistically significant and negative relationship between cash management and profitability, measured with cash conversion cycle, return on assets and return on equity. Their studies indicated that cash management was majorly studied as a component of working capital management. They further indicated that cash management is very important to generate higher rate of return and to maximize the shareholders' wealth, and the research works showed that the overall profitability in the SME sector is enhanced if cash is properly managed. The studies further showed that the shorter the cash conversion cycle, the more efficiently cash is managed and ultimately the more profitable the firm as less borrowing cost is involved. On the other hand, the longer the cash conversion cycle, less cash is available and ultimately decreasing profitability due to increased borrowing cost.

5.1.2 Objective Two: The relationship between Receivables Management and the Financial Performance of SMEs

Receivables management is an important issue for every business offering credit to its customers. Receivables management directly affects profitability of any firm (Raheman& Nasr, 2007). The findings of this study state that there is positive significant relationship between receivables management and financial performance of SMEs in Kampala Central Division. These findings are consistent with studies of Sharma & Kumar (2011) and Tanveer et al, (2016) in India and Pakistan who found a positive relationship between receivables management and profitability. The results showed that accounts receivable had positive and significant effect on profitability.

Research studies by Deloof (2003), Laziridis&Tryfonidis (2006), Garcia-Teruel& Martinez-Solano (2007), Samiloglu&Demrigunes (2008), Mathuva (2010), Venkata et al (2013) and Kasozi (2017) in Belgium, Greece, Spain, turkey, Kenya, India and South Africa respectively, all contradict and negate and point out to a negative relationship between accounts receivable and firm profitability. The negative relationship implies that firms which efficiently manage their receivables perform better than those do not.

5.1.3 Objective Three: The relationship between Inventory Management and the Financial Performance of SMEs

Inventory management is a set of controls and guidelines that monitor the levels of inventory and determine what levels should be held, when to replenish or stock up, and the quantity to order (Chandra, 2008). The aim of Inventory management is satisfying customer needs and keeping inventory costs at a minimum level and to avoid losing sales from stock-outs. An optimal level of inventory should be kept as holding too small can cause lost sales or delayed services while holding too much stock causes additional costs, obsolescence and storage costs, foregone interest, insurance, and damage (Gitman, 2009). According to Peterson & Joyce (2007), ROA can be maximized by either reducing the material cost or reducing the current assets tied up in the inventory or by increasing profits. Peterson & Joyce (2007), maintain that inventory management can make a direct contribution in increasing profitability by deciding inventory norms and through control systems. This is consistent with the findings of this study which indicate that inventory management and financial performance of SMEs in Kampala Central Division have a positive and significant relationship, and this means that if inventory is maintained at optimal level, the profitability will increase. The positive relationship further implies that firms which stock-up and maintain their inventory levels suffer less from stock-outs.

Studies done by Deloof (2003), Eneje et al (2012), Sekeroglu&Altan (2014), Kwadwo&Vipulesh (2015), and Kasozi (2017) in Belgium, Nigeria, Turkey, Ghana, India and South Africa respectively support the findings of this study and have found statistically that there is a positive relationship between inventory management and profitability of firms measured through inventory turnover and return on assets and net profit margin. These results were contradicted by studies done by Raheman& Nasr (2007), Cannon (2008), Jamal et al (2016), and Lyngstadas& Berg (2016) in Pakistan, USA, Malaysia, and Norway who stated that there is a negative relationship between inventory management and firm's profitability by using inventory turnover, inventory handling and gross profit margin and ROA. These studies argue that whenever inventory levels decrease profitability increases because the funds tied up in the inventory will be freed and circulate.

These studies indicate that inventory management is majorly studied as a component of Working Capital Management. They further indicate that inventory management is very important factor to be considered in enhancing and boosting performance of SMEs.

5.1.4 Objective Four: The relationship between Payables Management and the Financial Performance of SMEs

Accounts payable are suppliers whose invoices for goods or services have been processed but not yet been paid. Payables management entails the decision to balance the benefits of trade credit against the costs associated with the credit (Van-Horne &Wachowicz, 2008). Efficient management of accounts payables will optimize the cash outflow that will ensure the firm's liquidity is not adversely affected and ultimately the profitability of the firm will not be affected in the long run (Uremadu et al, 2012). With regard to payables, the firm is responsible for paying these obligations on a timely basis. Management of payables requires the establishment of internal controls for cash disbursements to ensure that cash is disbursed only upon proper authorization of management for valid business purposes.

Payables management is a very important for SMEs and will contribute to the profitability and survival of firms if it is managed adequately. Wilner (2000) argues that reducing supplier financing, by making quick payment, will result in substantial price deduction. Gitman(2009) claim that the aim of Payables Management is to prolong the time of payment as long as possible without damaging its credit rating.

The findings of this study clearly show that there is a negative and non-significant relationship between payables management and financial performance of SMEs in Kampala Central Division. These findings are in agreement with the findings of Ikechukwu & Nwakaego (2015) who examine the effect of the management of accounts payable on the profitability of Brewery companies in Nigeria. The results showed that accounts payable had negative but insignificant relationship with profitability ratio of companies under Brewery manufacturing companies in Nigeria.

Research studies made by Deloof (2003), Karaduman et al (2010), Lazaridis and Tryfonidis (2006), Padachi (2006), Enqvist et al (2009), Sharma & Kumar (2011), Eljelly (2014), and Mengesha (2014) in Belgium, Turkey, Greece, Mauritius, Finland, India, Saudi Arabia and Ethiopia respectively showed a negative relationship between ROA and Payables Management. These results are not in line with researches conducted by Raheman& Nasr (2007), Nyabwaga et al (2012), Wanjiku (2013) who established a positive relationship between ROA and the Payables management.

5.2 Conclusions

Based on the findings of this study, the following conclusions were derived regarding the relationship between working capital management and the financial performance of SMEs·

i. There is a significant and positive relationship between cash management and financial performance. This means that cash management is an important factor as it determines the level of financial performance and good financial performance is the result of efficient cash management Generally cash management is based on cash conversion cycle and is considered as an important factor in enhancing the performance of companies, since it shows how efficient a firm is in its stock up as per customer's demands, increased sales, payment of bills on time, investment of excess cash, collection of payments and getting preferential treatment from suppliers.
ii. There is a significant and positive relationship between receivables management and the financial performance of the SMEs under study. This means that the longer the credit period is extended for customers then the ROA will increase. This positive result is consistent with Shankar and Kumar (2011). Shankar and Kumar (2011) posit

that firms grant their customers a longer credit period to sustain in the market and respond to competition. However, this result is statistically significant, therefore, it can be said that for a good financial performance, receivables should be properly managed.

iii. There is a significant and positive relationship between inventory management and financial performance of SMEs in Kampala Central Division, and this means that if inventory is maintained at optimal level, the profitability will increase. Generally inventory management is considered as an important factor in enhancing the performance of firms, since it shows how efficient a firm is in its reconciliation of inventories, selling inventories in short period, provision of internal controls, reviewing stock levels on regular basis for updating, optimal ordering and replenishing inventories, and adequate provision for obsolete and inactive items.

iv. There is a negative and non-significant relationship between payables management and the financial performance of the SMEs under study. This means that unit increase in the variable shall bring about corresponding decrease in the profitability.

Thus, from the findings of this study it can be concluded that there is a positive and significant relationship, and working capital management positively contributes to the financial performance of SMEs in Kampala Central Division. This means that for a good financial performance, working capital components should be properly managed due to the reason that working capital components determine the level of financial performance and whenever working capital components are improved and properly managed, then the financial performance of SMEs increases. However, with regards to the alternative hypothesis for the purpose of the study as that working capital management significantly influences profitability of SMEs can be accepted.

5.3 Recommendations

5.3.1: Cash Management

According to the cash management aspect of SMEs in Kampala Central Division, it is an important source of competitive advantage to the business; and the success and failure of a business firm depends on the efficiency of cash management. Therefore, the researcher recommends that SMEs should maximize the availability of cash in order to meet its obligations. The available cash enables the businesses to have sufficient stocks as per customers' demands so as to increase sales; and pay bills on time. The researcher also recommends SMEs to invest adequately any excess cash.

5.3.2 Receivables Management

According to the receivables management aspect of SMEs in Kampala Central Division, the researcher recommends that SMEs should monitor their receivables closely and advises SMEs to maintain an optimal level of debtors lest they suffer from costs associated with bad debts, and managing credit among others. The researcher also recommends that firms should employ policies that enable businesses to shorten credit collection period, low levels of bad debts, and a sound credit policy in order to improve the profitability of SMEs. The management should review and follow up receivables, and a limit should be made in the amount of credit allowed for a single customer.

5.3.3 Inventory Management

According to the inventory management aspect of SMEs in Kampala Central Division, the researcher suggests that SMEs should pay more attention to the management of inventory since it has a larger influence on financial performance of SMEs. The researcher therefore suggests that SMEs should maintain an optimal level of inventory, as holding too small inventory can cause lost sales or delayed services while holding too much stock causes additional costs, obsolescence and storage costs, foregone interest, insurance and damage. The management should set up controls and guidelines that monitor the level of inventory and determine what levels should be held, when to replenish or stock up, and the quantity to order.

5.3.4 Payables Management

According to the payables management aspect of SMEs in Kampala Central Division, the researcher recommends that firms to pay bills on time to earn trust from suppliers. The management should make proper review and follow up of payables and establish internal controls for cash disbursement to ensure that cash is disbursed only upon proper authorization of management. The researcher also suggests that reducing supplier financing, by making quick payment, will result in substantial price deduction.

5.4 Limitations

The followings were the limitations of the study: poor response, this was in the case of unanswered and semi-answered questionnaires and unwillingness of the respondents to disclose the facts. The researcher found it difficult to access the business's confidential information. The researcher obtained an introductory letter and confirmed that the study is purely for academic purposes. The problem of time constraint, the researcher pursued his academics alongside undertaking the research during that short period. However, this did not limit the desire to collect important information for the study variables. Some respondents might have been hesitant to give all the required information, because of fear to expose the organization to its competitors. This most likely caused biased response. However, the researcher overcame this by spending time with the respondents to explain to them that the study is basically and purely for academic purposes. Questionnaire retrieval problems, this took place as all the sample questionnaires were not fully collected, this might limit the validity of the findings but to avoid this more questionnaires were given out to respondents and the researcher managed to retrieve a significant number of the questionnaires i.e. 320 retrieved questionnaires out of 327 and this represented 98% response rate. There might be limitations in the findings of the study due to the reason that the number of SMEs to be studied can't represent the whole SMEs in Kampala.

5.5 Contribution to Knowledge

The study has contributed to the knowledge that the existence of sound, proper and strong management of the working capital components (cash, receivables, inventory and payables) of SMEs can positively affect the financial performance; and policy makers, owners of SMEs, academicians and future researchers may be able to use the findings of this study so as to take corrective actions in proper review and follow up of working capital components. The study also provides a better understanding and deeper insights into working capital management practices. This study has shown the importance of working capital management to financial performance in the SMEs by considering Kampala Central Division, and this was not catered for in the studies carried out previously by Kazimoto (2016), and Mabonga (2014). One of the most prominent findings from this study is that it has provided evidence to support the fact that components of working capital can improve the state of profitability of SMEs in Kampala Central Division, Kampala District, Uganda.

The purpose of this study was to investigate the effects of working capital management on financial performance of SMEs in Kampala Central Division. So far most studies carried out focused on cash conversion cycle, accounts receivables, inventory turnover, and accounts payables from accounting perspective; and profit margin, sales growth, return on assets as the measures of financial performance. However, in this study the researcher has shifted the focus on working capital management from management perspective by focusing on cash management, receivables management, inventory management and payables management as the measures of working capital management and financial performance by considering profitability in terms of ROA and ROE. This is to say that the researcher tried to bring about how management of working capital components is related financial performance. This was not addressed by Kazimoto (2016), and Mabonga (2014).

5.6 Suggestions for Further Research

This research was a survey on working capital management and financial performance of SMEs in Kampala Central Division. The study considered cash management, receivables management, inventory management, and payables management under working capital management from management perspective, and profitability in terms of ROA and ROE under financial performance. Further research should be carried on working capital management and financial performance of SMEs in Kampala Central Division and in Kampala as a whole from other perspectives such as accounting by considering the cash conversion cycle, number of days' accounts receivables, number of days' inventory turnover, and the number of days' accounts payables as the independent variables to be related to financial performance in terms of net profit, gross profit, liquidity and financial efficiency.

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APPENDICES

APPENDIX A: Questionnaire

Dear Respondents,

As part of post graduate degree study requirement, I, MOHAMED ABDULALHI MOHAMUD, student of Kampala International University (KIU), am carrying out a research on **Working Capital Management and Financial Performance of SMEs in Kampala, Central Division.** I therefore kindly ask for your cooperation in this study by answering the questions in this questionnaire which will help me to get the information needed. This research is purely for academic purposes and the information obtained from you will be treated with at most confidentiality.

Please, take a few minutes of your time and answer the questions in the spaces provided.

Tick where necessary

SECTION A: WORKING CAPITAL MANAGEMENT OF SMEs

1. Please tick the appropriate box depending on your level of agreement or disagreement as arranged in .he 5 Likert Scale:

1	2	3	4	5
Strongly Disagree	Disagree	Not Sure	Agree	Strongly Agree

Nº	WORKING CAPITAL MANAGEMENT	RANKINGS				
	Cash Management	5	4	3	2	1
1	Cash management enables the business to have sufficient stocks as per customers' demands					
2	The cash management in my firm enables the business to have increased sales					

3	The cash management in my firm enables payments of my bills on required time					
4	The cash management in my firm ensures that any excess cash is adequately invested					
5	The cash management in my firm enables me to get preferential treatment from my suppliers through cash discounts					

	Inventory Management	**5**	**4**	**3**	**2**	**1**
1	Inventory management in this business is efficient and effective					
2	Management reviews the reconciliation of physical inventory counts to the inventory records					
3	Internal controls appear adequate for the inventory system					
4	Stock levels are reviewed on a regular basis to ensure they are up to date					
5	Optimal order and replenishment frequency are made on a regular basis as part of a continuous improvement process					
6	Adequate provision is made for obsolete and inactive items in inventories					
7	It takes a long period to sell our inventories or stocks to our customers					

	Receivables Management	5	4	3	2	1
1	The receivables of this business are properly managed					
2	There is a limit in the amount of receivables allowed for a single customer					
3	There is proper review and follow up of receivables in this business					
4	Proper measures are taken if there is delay in collection of receivables					

	Payables Management	5	4	3	2	1
1	There is proper management of accounts payable in our business					
2	Our creditors are paid on time in order to earn trust from them					
3	There is proper review and follow up of payables in this business					

SECTION B: FINANCIAL PERFORMANCE OF SMEs.

2. Please tick the appropriate box depending on your level of agreement or disagreement as arranged in the 5 Likert Scale:

1	2	3	4	5
Strongly Disagree	Disagree	Not Sure	Agree	Strongly Agree

Nº	PROFITABILITY	RANKINGS				
	Return On Assets	**5**	**4**	**3**	**2**	**1**
1	This business has expanded because of high returns on assets					
2	The current assets are generative of more profits in your business					
3	There has been a gain in profits on the capital employed by the business					
4	The net operating assets sufficiently support the daily operations					
5	The Return on Assets is higher than the costs of operation in the previous periods					
	Return On Equity	**5**	**4**	**3**	**2**	**1**
1	The return on equity is a financial measure of our business					
2	Owners of this business receive relatively high returns on equity					
3	The net profit margins of this business are high					
4	The state of capital in this business is steadily growing					

Source: *Wu, (2009), Oroka& Valentine, (2013), Nguyen (2001), Abdelrahim (2007)*

APPENDIX B: TABLE FOR DETERMINING SAMPLE SIZE FROM A GIVENPOPULATION

N	S	N	S	N	S	N	S	N	S
10	10	100	80	280	162	800	260	2800	338
15	14	110	86	290	165	850	265	3000	341
20	19	120	92	300	169	900	269	3500	246
25	24	130	97	320	175	950	274	4000	351
30	28	140	103	340	181	1000	278	4500	351
35	32	150	108	360	186	1100	285	5000	357
40	36	160	113	380	181	1200	291	6000	361
45	40	180	118	400	196	1300	297	7000	364
50	44	190	123	420	201	1400	302	8000	367
55	48	200	127	440	205	1500	306	9000	368
60	52	210	132	460	210	1600	310	10000	373
65	56	220	136	480	214	1700	313	15000	375
70	59	230	140	500	217	1800	317	20000	377
75	63	240	144	550	225	1900	320	30000	379
80	66	250	148	600	234	2000	322	40000	380
85	70	260	152	650	242	2200	327	50000	381
90	73	270	155	700	248	2400	331	75000	382
95	76	270	159	750	256	2600	335	100000	384

Note: "N" is population size

"S" is sample size.

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