Working Capital Management Cycle and Profitability of Household Supermarkets in Kenya: A Literature Review

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***Abstract:* - Working capital management involves management of short-term assets and liabilities. The purpose of this study was to examine the working capital management cycle in relation to profitability of household supermarket in Kenya. The objectives of the study were to evaluate the receivable conversion period, payable Deferral period, and inventory conversion period on the profitability of Household supermarket in Kenya. This study was guided by Operating Cycle Theory. The study used literature review methodology. The research concluded that firms that manage working capital efficiently enjoy the benefit of long survival in business, and that shareholders' value can be raised by reducing account receivable days, by hiking stocks to a sensible level, by taking long to pay suppliers yet ensuring good terms and by minimizing the CCC days.**

***Key Words:* Receivables management, Payables Management, Inventory Management, Profitability.**

I. INTRODUCTION

Maximization of profit is the main goal of every business. A profitable business that earns a high profit has ability to increase owners' wealth while any business without profit will not survive in the long run. Failure to manage working capital management (WCM) may result to incapacity to guarantee smooth running of a business' daily operations (Aminu, 2012). Employing an effective method of managing WCM is a remarkable way for a supermarket to retain its earnings.

Incompetent methods of handling short-term resources in supermarkets have led to their downfall. Mbuthia and Rotich (2014) held that mismanagement of working capital was the main contribution of the collapse of Uchumi supermarket. For example, continuous supply of stock was affected where business could not clear debts on time due to shortage of funds. Violation of agreement with suppliers resulted to legal actions and massively reduced the supermarkets' income. A supermarket cannot meet financial obligation if there is no sound management of working capital. The negative practices harmfully affect the firm's returns. Nakumatt supermarket Ltd collapsed and sold off some of its branches due to mismanagement of working capital (Ogwang, 2016). The supermarket could not sustain branches due to cash flow problems.

Working capital is like the breath of life passing through the respiratory system of a business and giving it life. When elements of working capital lose life, death of the business is the ultimate outcome just like cut of breath leads to death in a human being. Firms require funds to meet financial obligations. Van Home and Wachowicz, (2005) reasoned that a business with very low short-term assets might experience inadequacy and hardships in operations. On the other hand, extreme levels of short-term assets may harmfully affect the business revenue.

The capacity of a firm to clear amounts owing before deadline without tampering with the business activity is an expression of strength that is checked using liquidity measures. This guards a business against the threat of maintaining either insufficient or excessive level of working capital because both affect the business negatively. Financial managers in supermarkets should have correct management skills that will capacitate them making relevant decision regarding the extent to which each element of short-term assets is held (Artrill, 2012). This put a requirement for forecasting, analytical and controlling skills on personnel responsible to establish smooth running of the business at all times,

Working capital is the outcome of reducing a short-term liability is from a short-term asset (Artrill, 2012). Ingredients of short-term assets include stock, debtors, prepayments and cash while short-term liabilities are made of creditors and bank overdraft. The aim of WCM in a supermarket is to ensure that the business is able to continue running and that it has enough cash flow to meet its operation expenses and short-term maturing balances.

II. PROBLEM STATEMENT

A supermarket cannot run its operation smoothly without accurate management of receivables, cash, payables and inventory to meet its financial payments (Eljelly, 2004). This vital activity helps in retaining profit, liquidity and solvency for continued existence of a supermarket.

Kaleem (2012) noted that supermarkets encounter liquidity problems, low profits, more funds tied in working capital, and inability to release capital for funding growth. The study suggested that supermarkets can reduce these problems by rechecking their determinants of working capital (WC) to ensure better practices and increase chances of success in business.

Ratemo (2018) observed that high levels of due payables that affect restocking procedure that leads to low sales which eventually affect a supermarkets profit. Inventory was also observed to have a great significant on the supermarket's profit. The study projected that supermarkets enter into long term contracts with different suppliers to ensure a longer period of credit that will help in cash management that will improve profit.

Mathuva (2010) proposed that shareholders' value can be created by reducing debtors' days, increasing inventories to a reasonable level, delaying suppliers' payments while ensuring healthy relationship with creditors and by reducing the cycle of cash conversion to minimum.

However, large supermarkets like Nakumatt and Uchumi supermarket Limited have collapsed (Ogwang, 2016; Mbuthia & Rotich, 2014) while Tuskys supermarket ltd is encountering serious challenges (Anyanzwa & Njau, 2020). The downfall of these mega limited liability companies triggers a question on the link between supermarkets WCM and profits. Have recommendations by different researchers like (Retemo, 2018; Kaleem, 2012 and Mathuva, 2010) who found existense of significant relations of WCM and firms profits trickled down to retail supermarkets?

III. LITERATURE REVIEW

a. Receivable Collection Period and Profitability

Jindal (2017) conducted a study on how debtor's management affects profitability of commercial vehicles in India. The study used Debtors' turnover ratio to measure efficiency in debtors' management based on return on capital employed. The study covered the period 2009 to 2016. The outcome showed a noteworthy positive link between debtors' turnover ratio and the company's profitability, with an implication that debtors' management is a central focus for increasing profitability in vehicle business. These findings put a caution to good management of credit sales.

Dhar (2018) examined the impact of managing debtors on circulating capital and profitability of cement firms in India where the findings revealed that the sampled firms were efficiently managing debtors and this was revealed in the short collection period. The outcome displayed that competent management of debtors had a positive effect to circulating capital and profitability. This research was conducted in cement factories of India.

A study conducted by Ikechukwu and Nwakaego (2015) revealed a substantial optimistic effect of debtors on profit of companies in Nigeria dealing with manufacture of products like chemicals, building materials and paint. Account receivable was seen to have a positive significant effect with profitability ratio at one percent levels of significance, implying that when units of variables rises, profitability ratio of the building materials, cement and chemicals will also rise. This shows accurate management of debtors' collection period is very crucial and should be carefully controlled and made practical in a business.

Mbula et al. (2016) investigated the result of debtor's administration had on financial performance of locally based companies with start-up funds sourced from the government. The study findings revealed financial performance of these firms is positively related to debtors. In conclusion, the researchers determined that managers of these firms should fix better credit plans to improve effectual supervision of debtors' balances to ensure better financial performance.

b. Payables Deferral Period and Profitability

In Nigeria, Ikechukwu and Nwakaego (2015) tested payables' ratio and financial performance on Industrial /domestic manufacturing companies. The findings revealed a positive link between payable deferral period and company's profit. The rate of growth in sales and debt ratio displayed an adverse effect on the companies selected.

Hassan et al. (2015) targeted four companies located in Gorowe, Puntland in Somalia to establish how WCM has affected financial performance of water processing companies. The study covered the period from 2011 to 2015. The study employed agency, transaction and WCM cycle theories. Multiple linear regression of ROA was used on cash conversion cycle (CCC), stock turnover, receivable turnover and payable turnover ratios. Payable turnover ratio was found to have no effect on the performance of water processing companies as shown on ROA. The researchers concluded that the outcome could have been influenced by unstable business environment in Somalia.

Nyachwaya (2018) studied effects of accounts payable on profitability of Kenya agricultural firms using a case study of James Finlay's located in Kericho County. The outcome of the inquiry was a negative effect on profitability. Retaining high levels of accounts payable due to its low cost yet sustaining good relationship with supplier companies due to ease of access that are agreeably sorted out without legal action was given as suggestions from the study. The study considered accounts payable and profitability in agricultural sector.

Rotich and Achode (2016) tested the link between accounts payable and achievements of 16 manufacturing firms listed in Nairobi Securities Exchange (NSE) covering year 2000 – 2013. The outcome of the test revealed a direct favorable relationship between payables and profitability in most manufacturing firms listed. From the study, company managers and financial officers were advised to build long term relationship with their suppliers in order to access credit supplies in a quick and stress free-way. This is because increase in credit can boost a business performance through increased profit.

Ratemo (2018) examined how working capital management has influenced profit in thirty-one supermarkets in Nairobi

County. Individual supermarkets and the ministry of labor availed financial records used as data in the investigation. The study revealed that payable turnover ratio was significantly linked supermarkets' profit. The researcher advised that management of supermarkets should enter into long term contracts with different suppliers to guarantee longer period as this will help in managing cash flows hence improving profit.

c. Inventory Conversion Period (ICP) and Profitability

In Greece, Kolias (2011) tested inventory ratio behavior in the country's retail sector covering the period 2000-2005 using 566 retail companies. The observed an adverse relationship between stock turnover ratio and gross profit. The reaction of the ratio to different sales changes was also studied. The study projected that sales changes when businesses are operated in sales declined regions.

In Nigeria, Etale (2016) applied multiple regression technique in his academic work to test the effects of inventory administration on profit of listed breweries companies from year 2005 to 2014. Multiple regression analysis was used to analyze data. The study revealed that an efficient inventory cost control had a favorable effect on output of brewery firms. The researcher suggested that firms apply effective, proficient inventory cost practices, and modern technology for real cost management. Qualified professionals should be repeatedly trained in managing inventory cost.

In Ghana, Premper (2015) studied manufacturing companies listed in the country's stock exchange from the period 2004 to 2014. Data was obtained from four of the companies. Results from the test showed that efficient management of the inventory as the main variable was significantly linked to the profit of the manufacturing firms.

Mathuva explored the influence components of WCM have on corporate profitability of listed companies in Kenya. The study covered a period of fifteen years from 2008 to 2015. The study revealed that time taken by a firm to change stock to sales and profits are related. Firms should keep reasonable stock levels to avoid losing business opportunities due costs related to shortage.

IV. CASH CONVERSION CYCLE (CCC) THEORY

Deloof (2003) explored large Belgian non-financial companies for five years from1992 to 1996 and tested the link between WCM and profitability. The study selected 1009 companies and used the number of days to measure trade credit and inventory policy. Accountes receivables, payables, inentories and CCC were used as a full measure of WCM. The outcome proposed that managers can increase profit by lessening the number of days, accounts receivable and inventories. Companies with less profit wait longer to clear bills. Nabonee (2008) Stated that a company can achieve better results by reducing the average number of days it holds inventories.

Ejelly (2004) inspected the link between profit and flow of cash on 929 Saudi Arabian Joint stock companies. He identified that the companies' liquidity level and profits had a negative significant link. The also noted that cash gap at industry level is more relevant as a metric of liquidity than current ratio that affects a firms' profitability.

Nwunde and Agbo (2018) inspected the effects of CCC on return on assets employed for sampled insurance firms in Nigeria covering the period 2001to2011. The researcher used multiple regression technique for analyzing the model for testing hypothesis. Return on asset was used as a metric of profit while CCC presented descriptive and control variables. The outcome displayed that the ratio had an adverse and substantial impact on profitability. Recommendations of the study propose that Nigerian insurance companies lessened their CCC days to boost profit.

Mathai (2010) noted a weak non - significant negative link between average collection days, average payment period and net operating profit when she discussed retail supermarket chains in Kenya. CCC was observed to have a weak significant relationship with the supermarkets' net operating profit. The study suggested that supermarkets should have WCM which will guide them in making judgments on investment mix and plan.

V. CONCLUSION

Firms that manage working capital efficiently enjoy the benefit of long survival in business. The empirical literature shows that the way short term assets and liabilities are managed will have a direct effect on the supermarkets' profit and balanced liquidity. This will call for better management of receivables, cash, payables and inventories because of their influence on returns. Managers will be expected to define the correct level of debtors that will increase supermarket sales without incurring bad debt costs. The intent of maintaining the right cash balance will be made practical through accurate collection and payment procedures. Time taken to settle payables' debts without damaging relationship with suppliers will also be put in to consideration. The supermarket will be expected to maintain best level of stocks to meet clients' demand yet paying attention to costs related

The bulk of the literature portrays WCM as very central in business due to its contribution to the profit and the worth of the firm. Various scholars in Kenya discovered guiding principles that can add to the profit of a company. Ratemo (2018) discussed thirty-one supermarkets in Nairobi County and directed that long term contracts be used as a means to boost profit. Mathai (2010) tested six supermarkets and advised that supermarkets should have WCM which will act as a guide in making judgments on investment mix and plans leading to higher profits. Additionally, Mathuva (2010) proposed that shareholders value can be raised by reducing account receivable days, by hiking stocks to a sensible level, by taking long to pay suppliers yet ensuring good terms and by minimizing the CCC days.

Conclusively, even though this field of WCM and profitability have been covered to a wide extent by various academics, it is useful to find out how much of their recommendations have been made practical in individual retail supermarkets. A business that maintains a steady profit trend without engaging into excessive credit can be said to be successful (Kamau, 2021). This applies also to the household supermarkets. Properly managed working capital will result to efficiency in operations (minimum Cash Conversion Cycle), which will have a positive influence on profitability as illustrated in Figure 1 below.

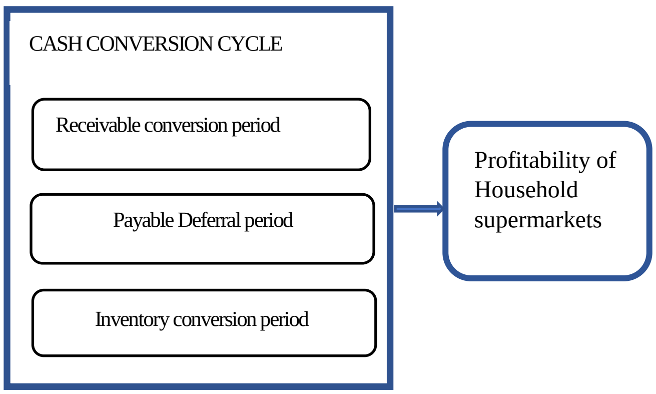

Figure 1: Relationship between CCC and Profitability

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