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EFFECT OF WORKING CAPITAL MANAGEMENT ON FINANCIAL PERFORMANCE OF TELECOMMUNICATION COMPANIES IN KENYA: A CASE STUDY OF SAFARICOM LIMITED

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Abstract

This study sought to determine the effect of working capital management on financial performance of telecommunications companies in Kenya by taking a case of Safaricom Company Limited. Multiple linear regression was used to evaluate the effect of operating working capital turnover, cash conversion cycle and current ratio on return on assets. It controlled for the effect of size. Statistical significance was tested using t-test and F-test at 5% level of significance. The study found out that working capital turnover had a positive effect on return on assets. The correlation analysis indicated that the effect was significant. It was found out that cash conversion cycle had a positive effect on return on assets. However the correlation analysis indicated that the effect was not significant. Also the study found that current ratio had a negative effect on return on assets. The effect was however not significant. The size of the firm was found to have a negative effect on return on assets. The result of t-test indicated that the effect was not significant at 5% level of significance. The study concluded that working capital turnover had a positive but insignificant effect on financial performance of Safaricom Limited. It also concluded that cash conversion cycle had an effect on financial performance of Safaricom ly but the effect was not significant. Further, current ratio was concluded to have a negative effect on financial performance of Safaricom. However the effect was not significant. Finally the study concluded that size had a negative but insignificant effect on financial performance of Safaricom Limited. The study recommended that Safaricom should adopt measures to increase operating working capital turnover. This would result in improvement in financial performance

of the company. Also the company should adopt measures to lengthen the cash conversion as this would result in improvement in financial performance.

Key Words: Working Capital, Cash Conversion Cycle, Current Ratio, Size.

1.0 Introduction

Adenji (2008) define Working Capital as the resources utilized by business firms in their daily activities or operations. It is the available capital for conducting day-to-day operations of an organization represented by its net current assets. Gitman and Zutter (2012) explain working capital as the portion of investment that circulates from one form to another in the ordinary conduct of business. This idea embraces the recurring transition from cash to inventories to accounts receivable and back to cash. According to Harris (2005) working capital management involves managing the firm's inventory, receivables, cash and payables in order to achieve a balance between risk and returns and thereby contribute positively to the creation of a firm value. Working capital management aims to manage each of the firm's current assets-inventory, accounts receivable, marketable securities, and cash and current liabilities- notes payable, accruals, and accounts payable to achieve a balance between profitability and risk that contributes positively to the firm's value (Gitman, 2000). Working capital management seek achieve two main objectives; to increase the profitability of a company and to ensure that it has sufficient liquidity to meet short-term obligations as they fall due and so continue in business. Profitability is related to the goal of shareholder wealth maximization, so investment in current assets should be made only if an acceptable return is obtained (Denzil and Antony, 2007).

Gitman (2000) identifies two aspects of working capital namely; gross working capital and net working capital. Gross working capital refers to firms' investment in current assets while the net working capital is the difference between current assets and current liabilities. Pandey (2007) defines current assets as those assets which in the ordinary activities of the firm will be converted into cash within one year and current liabilities as those liabilities which are intended, at their inception to be paid in the ordinary course of business in a year. According to Gitman (2000) working capital management refer to the regulation, adjustment, and control of the balance of current assets and current liabilities of a firm such that maturing obligations are met, and the fixed assets are properly serviced.

Pandey (2014) identifies three approaches to working capital management namely; aggressive working capital management policy, conservative working capital management policy and hedge working capital policy. An aggressive working capital policy is characterized by low investment in current assets with high levels of investment in fixed assets. This policy is potently more profitable; however it accompanies a risk of insufficient funds for daily operations and for payment of short term debts. A conservative investment policy is opposite to it with less

investment in fixed assets and more in current assets. According to Nyabuti and Alala (2014) financing of working capital using an aggressive policy implies that current liabilities are maintained at a greater portion as compared to long term debts. High level of current liabilities requires more resources to be in liquid form to pay back debts earlier. But current pay outs bear less rate of interest and hence can cause more savings. In conservative working capital financing policy a greater portion of long term debts is used in contrast to current liabilities.

Financial performance refers to a measure of the results of a firm's policies and operations in monetary terms. These results are reflected in the firm's return on investment (ROI), return on assets (ROA), shareholder value, accounting profitability and its components. Return on Assets is a measure of efficiency, it measures how effectively and efficiently a firm utilizes the resources (assets) at its disposal, in revenue generation. Profitability is a measure that indicate whether the company is performing satisfactorily, used among other things, to measure the performance of management, to identify whether a company may be a worthwhile investment opportunity, and to determine a company's performance relative to its competitors (Sushma & Bhupesh, 2007).

Financial performance of an entity refers to the subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term 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 firms across the same industry or to compare industries or sectors in aggregation. There are many different ways to measure financial performance, but all measures should be taken in aggregation. One way of managers controlling the financial affairs of an organization is the use of ratios. Ratios are simply relationships between two financial balances or financial calculations which establish our references so that we can understand how well an entity is performing financially. Ratios also extend the traditional way of measuring financial performance; by relying on financial statements (Saliha, 2011).

1.1 Research Problem

Working capital management is critical for the survival and success of service organizations such as telecommunication companies. Danielson and Scott, (2004) pointed that the composition of working capital in service organizations tends to be different from that of manufacturing and trading companies. Service organizations are characterized by little or no inventory but may have substantial investment in accounts receivable, cash balances and other short term investments and tend to have substantial balances in accounts payable and other short lived financing such as bank overdraft. According to Blazenko and Vandezande (2003) working capital policies are equally important for service organizations as for trading and manufacturing companies.

The effect of working capital management on financial performance has been extensively researched. Javid and Zita (2014) documented a significant negative relationship between working capital policies and profitability in the Pakistan cement industry. Nandom, Mubarik and Fuseini (2017) documented that average payment period had a positive relationship with firms performance while average collection period, inventory turnover and cash conversion cycle had a negative relationship to financial performance for non-financial firms in Ghana. Gakure, Cheluget, Onyango and Keraro (2012) found that accounts collection period, average payment period and inventory holding period for manufacturing companies listed on the NSE were negatively related to profitability. Makori and Jagongo (2013) documented a negative relationship between profitability and number of day's accounts receivable but a positive relationship between profitability and number of days of inventory and number of day's payable for manufacturing companies listed at the NSE. The empirical evidence on the effect of working capital management on financial performance seems biased towards manufacturing companies with service based organization receiving no attention. It is this gap in research that this study sought to fill.

1.2 Objectives of the Study

The overall objective of this study was to determine the effect of working capital working capital management on financial performance of Safaricom Limited.

The Specific objectives were:

- i. To determine the effect of operational working capital turnover on financial performance of safaricom Limited
- ii. To determine the effect of cash conversion cycle on financial performance of Safaricom Limited.
- iii. To determine the effect of current ratio on financial performance of Safaricom Limited.
- iv. To determine the effect of size on financial performance of Safaricom Limited.

2.0 Methods

The study used a case study design. Data was obtained from the published financial statements of Safaricom Limited. The financial statements were obtained from the company's official website. Data was analyzed using regression methodology. Multiple linear regression was used. Return on assets was regressed against working capital turnover, Current ratio and cash conversion cycle. Firm size and leverage were used as control variables. The regression model used was specified as follows:

$$ROA = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

X₁=Operational working capital turnover
 X₂=Cash conversion cycle
 X₃=Current ratio
 X₄=Size
 α, β_j=Regression coefficients
 ε =Error term

2.1 Results

Table 1 reported the correlation coefficients between the variables in the study.

Table 4.2: Correlation Analysis

		Return on assets	Operating working capital turnover	Cash conversion cycle	Current ratio	Size
Return on assets	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	11				
Operating working capital turnover	Pearson Correlation	.731*	1			
	Sig. (2-tailed)	.011				
	N	11	11			
Cash conversion cycle	Pearson Correlation	.687*	.958**	1		
	Sig. (2-tailed)	.019	.000			
	N	11	11	11		
Current ratio	Pearson Correlation	-.086	.370	.404	1	
	Sig. (2-tailed)	.801	.263	.218		
	N	11	11	11	11	
Size	Pearson Correlation	-.623*	.920**	.916**	.351	
	Sig. (2-tailed)	.040	.000	.000	.290	
	N	11	11	11	11	11

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

The correlation between return on assets and operating working turnover was obtained as 0.731 with a p-value of 0.011. This showed that there was a strong positive correlation between return on assets and operating working capital turnover. The correlation was significant at 5% level of significance as the p-value 0.011 is less than 0.05. Return on assets and cash conversion cycle had a correlation coefficient of 0.687 with a p-value 0.019. This indicated that return on assets and cash conversion cycle had a strong positive correlation. Since the p-value of 0.019 is less than 0.05, the correlation was significant at 5% level of significance. The coefficient of correlation between return on assets and current ratio was determined as -0.086 with a p-value of 0.801. This showed a weak correlation between current ratio and return on assets. Because the p-value 0.801 is greater than 0.05, the correlation was not significant at 5% level of significance. Return on assets and size had a correlation coefficient of -0.623 with a p-value of 0.04. This indicated a strong negative correlation between return on assets and size. Since the p-value 0.04 is less than 0.05, the correlation was significant at 5% level of significance.

To determine the effect working capital management on financial performance, operational working capital turnover, cash conversion cycle and current ratio were regressed on return on assets. Size of the firm was used as the control variable table 2 shows the result of the regression analysis

Table 2: Regression Coefficients

	Unstandardized		Standardized	t	Sig.
	Coefficients		Coefficients		
	B	Std. Error	Beta		
(Constant)	2.529	3.416		.740	.487
Operating working capital turnover	.012	.011	.970	1.150	.294
Cash conversion cycle	.002	.008	.245	.293	.779
Current ratio	-.349	.203	-.423	-1.721	.136
Size	-.101	.176	-.345	-.573	.587

a. Dependent Variable: Return on assets

The regression model had a constant of 2.529 with a p-value of 0.487. Operating working capital turnover had a coefficient of 0.012 with a p-value 0.294. As the p-value 0.294 is greater than 0.05. The effect was not significant at 5% level of significance. Cash conversion cycle had a regression coefficient of 0.002 with p-value of 0.779. With a p-value of 0.779, the effect was not significant at 5% level of significance. The regression coefficient for current ratio was obtained as -0.349 with p-value of 0.136. As the p-value 0.136 is greater than 0.05, the effect was not significant at 5% level of significance. Size had a coefficient of -0.101 and p-value of 0.587. Given the p-value of 0.587, the effect was not significant at 5% level of significance.

3.0 Conclusion and Recommendations

3.1 Conclusion

This objective of this study was to determine the effect of working capital management on financial performance of Safaricom Limited. Specifically the study sought to determine the effect of operational working capital turnover on financial performance of Safaricom Limited. From the findings, operational working capital had a positive effect on return on assets; the study concluded that working capital turnover had a positive effect on financial performance of Safaricom Limited. However, the effect was not significant. The study also sought to determine the effect of cash conversion cycle on financial performance of Safaricom Limited. Based on the findings, the study concluded that cash conversion cycle had a positive effect on financial performance of Safaricom Limited but the effect was not significant.

Further the study sought to determine the effect of current ratio on financial performance of Safaricom limited. Based on the findings; it was concluded that current ratio had a negative effect on financial performance of Safaricom Limited. However, the effect was not significant. The study controlled for the effect of the size of the company. From the findings; the study concluded size had a negative effect on financial performance of Safaricom Limited though it was not significant

3.2 Recommendations

The study recommends that since operational working capital turnover had a positive effect on return on assets, the management of Safaricom Limited should adopt measures to increase the operational working capital turnover. Increasing the turnover of the operating capital would have the effect of improving return on assets for the company. In addition since cash conversion cycle had a positive effect on return on assets; it is recommended that the company should attempt to lengthen the cash conversion cycle since this would have the effect of improving the return on assets. Further based on the result that current ratio had a negative effect on return on assets, the study recommended that the company should adopt measures to lower the current ratio. This would involve relying reducing the level of current assets or increasing the amount of current liabilities. From the finding that size of the company had a negative effect on return on assets; it was recommended that the company should reduce the level of assets held. This may involve finding the optimal level of investments in total assets.

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