



EFFECT OF WORKING CAPITAL MANAGEMENT PRACTICE ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KANO METROPOLIS

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ABSTRACT

This study examines the effect of working capital management on the performance of Small and Medium Enterprises (SMEs) in Kano Metropolis. The study employs the survey research design and questionnaire was used to source for primary data from 210 respondents. The study found that there is significant effect of cash sales on financial performance of SMEs in Kano Metropolis, there is significant effect of operating expenses on financial performance of SMEs in Kano Metropolis and there is significant effect of cash conversion on financial performance of SMEs in Kano Metropolis. The study recommends that financial managers should ensure that each components of working capital (account receivable, account payable, cash, inventory, and current assets) are efficiently and effectively managed to avoid waste and create value for the firms.

Keywords: Working Capital, Financial Performance, Small and Medium Enterprises

1. INTRODUCTION

Survival of the organization is more uncertain even though the companies are earning profit, unless they can meet the short-term obligations. Corporate finance basically deals with three decisions such as capital structure decisions, capital budgeting decisions, and working capital management decisions. Among these Working capital



is known as life giving force for any economic unit and its management is considered among the most important function of corporate management. Every organization whether, profit oriented or not, irrespective of size and nature of business, requires necessary amount of working capital. Working capital is the most crucial factor for maintaining liquidity, survival, solvency and profitability of business (Mathuva, 2018).

Many organizations are owned by group of people or Association, firms, industries and government with the aim of maximizing profits. The growth of Small and Medium Size enterprises is very essential to the economies of countries. The success of the SMEs has a direct impact on the growth of emerging economies through their contribution to employment, foreign trade, direct foreign investment, social change and technological advancement in the industries (Kulkanya, 2017).

Small firms play a critical role in providing job opportunities, nurturing a culture of entrepreneurship and opening up new business opportunities. They are recognized and acknowledged worldwide as vital and significant contributors to economic development, introduction and diffusion of new technology, ability in generating potential entrepreneurs and skilled workers for the industrialization process both nationally and internationally (Akinsulire, 2017).

Prior research conducted by researchers has partly attributed a high failure rate of SMEs to ineffective working-capital-management practices (Adedayo, 2017; Agarwal, 2016; Barine, 2017). More specifically, the study has indicated that most SMEs employ ineffective cash-flow management practices, which hamper their ability to fund strategic investments, or burden them with excessive interest payments. Many of these entities do not prepare cash budgets or forecasts, do not conduct bank reconciliations and cannot monitor their cash flows on a real-time basis (Nwude, 2017, Nazir & Afza, 2017). Worse still, some have no bank accounts and appear to be ignorant about their liquidity. Many SMEs also take a passive approach to their cash management, rely on manual processes or simple accounting software to manage their cash even as their businesses grow. Eventually these businesses face liquidity problems that result in a close-down.

Yet, other studies have focused on the factors that inhibit SMEs from managing their working-capital effectively (Mathuva, 2018; Gujarati & Sangeetha, 2018). Key



among the factors identified includes a lack of financial management skills which undermines these entities' ability to manage their current assets and current liabilities. In addition, most SMEs lack adequate resources such as time and personnel. Because of a lack of adequate resources, many owner-managers of SMEs perform numerous roles, which limit the time available for working capital management. Besides, the lack of resources also undermines the training opportunities available for staff development.

Sound working-capital management is vital for the long-term success of any business as no business can survive if it fails to meet its day to day obligations (Nwankwo & Osho, 2016). Shortage or ineffective management of cash can result in loss of cash discounts or non-payment of obligations when they fall due (Smith, 2017). Ineffective management of receivables can result in an increase in bad debts, whereas avoidance of receivables by selling strictly on a cash basis can reduce sales volumes or compel an entity to sell at a loss (Narasimhan & Murty, 2017).

Ineffective management of payables on the other hand undermines an entity's bargaining position when seeking credit, damages its reputation when it fails to meet its obligations, stagnates its growth as lenders refrain from advancing credit and ultimately raises the cost of borrowing. Although effective working-capital management is important to all business entities, it is the SMEs which should take working-capital management more seriously. This is because these entities are more vulnerable to working-capital fluctuations, more susceptible to cash shortages due to limited ability to raise finance and have most of their assets in the form of current assets and their liabilities in form of current liabilities (Makori & Jagongo, 2017). In addition, SMEs in various states of the nation, which SMEs in Kano are not exempted, make inefficient use of their accounting resources and given the importance of Fast-Moving Consumer Goods (FMCG) to the economy of Nigeria, it is vital that their working capital management practices be investigated.

Regarding the importance of working capital management to SMEs, only a few studies have been conducted in Kano State that investigated the management of working capital by these entities. Yet, less attention was paid by previous studies to examine the effect of working capital management of performance of SMEs in Kano Metropolis, hence, the need for this current study. Therefore, this study seek to



examine the effect of working capital management practice on financial performance of Small and Medium Enterprises in Kano Metropolis.

The aim of this research is to examine the relationship between working capital management and firm performance of listed manufacturing firms in Nigeria. To achieve this aim the following specific objectives of this study are to:

- i. Determine the effect of cash sales on financial performance of SMEs in Kano Metropolis
- ii. Determine the effect of operating expenses on financial performance of SMEs in Kano Metropolis
- iii. Determine the effect of cash conversion on financial performance of SMEs in Kano Metropolis.

Hypotheses of the Study

- H₁: There is no significant effect of cash sales on financial performance of SMEs in Kano Metropolis.
- H₂: There is no significant effect of operating expenses on financial performance of SMEs in Kano Metropolis.
- H₃: There is no significant effect of cash conversion on financial performance of SMEs in Kano Metropolis.

2. LITERATURE REVIEW

Concept of Working Capital

Akinsulire (2017) postulated working capital to be the amount invested in assets that are expected to be realised within the of year's trading. It is not a permanent investment but an investment which is continuous in nature and can be turn over severally during the year. Working capital refers to the fund available for the day to day running of a business. Working capital offers huge opportunities that could be released with sustainability within a relative short period of time (Lazaridis & Tryfonidis, 2017). Adeniji (2018), defined working capital as "the capital available



for conducting the day to day operations of an organization represented by its net current assets”.

Dong and Su (2018), defined working capital as current assets minus current liabilities. He said that, current assets represent assets most likely to be converted into cash. While current liabilities represent debts that must be satisfied in the current period. Therefore sufficient working capital must be provided in order to take care of the normal processes of purchasing raw materials into finished products and selling the products for cash. Working capital can be discussed under gross and net working capital:

Gross working capital refers to the company’s investment in current assets. The financial analyst basically deals with gross working capital because it is constantly involved in providing the correct amount for current assets for the company at all times. Net working capital is the difference between current assets and current liabilities. Is also means the excess of current assets over current liabilities. Current assets are those assets that are converted into cash within one year or one operating cycle. Example includes; cash, account receivable (debtors), inventory (stock), short-term securities. Current liabilities are obligations that are to be performed within one year. Examples: accounts payable (creditors), accrued expenses payable, taxes payable, unearned revenues, bills payable (Dong & Su, 2018),

Permanent Working Capital is the minimum level of current assets while fluctuating working capital is the extra working capital needed to support the changing production and sales of the firm. For example, extra inventory of finished goods will have to be maintained to support increase in sales and investment in debtors. If there is decrease in sales, investment in raw materials, work-in-progress and finished goods will also fall. Both are necessary to facilitate production and sales through the operating cycle.

Working Capital Management

Working capital management involves the management of both current assets and current liabilities efficiently and effectively. According to Eljelly (2017), working capital management involves planning and controlling current assets and current liabilities in a manner that eliminates the risk of inability to meet due short-term



obligations on the one hand and avoid excessive investment in these assets on the other hand”.

Working capital management also refers to the management of investments/divestments in current assets and increases and decreases in current liabilities (Nwude, 2017). The management of working capital involves the determination of optimum level of working capital to keep, monitoring and controlling the level of individual components of working capital to ensure that the optimum level is not exceeded, and the provision of funds to finance current assets.

Working capital management is a very important component of any firm because it directly affects the liquidity, profitability and growth and is important to the financial health of businesses of all sizes as the amounts invested in working capital are often high in proportion to the total assets employed (Alipour, 2017). It involves the planning and controlling of current assets and liabilities in a manner that eliminates the risk of inability to meet short-term obligations and avoid excessive investments in these assets (Lazaridis & Tryfonidis, 2017).

This management of short-term assets is as important as the management of long-term financial assets, since it directly contributes to the maximization of a business’s profitability, liquidity and total performance. Consequently, businesses can minimize risk and improve the overall performance by understanding the role and drivers of working capital (Lazaridis & Tryfonidis, 2017). Also, as established by several researchers (Kulkanya, 2017; Padachi, 2017) efficient management of working capital is pivotal to the health and performance of small firms hence their view that firms should employ the use of efficient working capital management practices as a strategy of improving their value. In this research, the construct on the working capital management is focused on its determinants, objectives, circle, and its components on firm performance.

Determinant of Working Capital Management

There are no specific set of rules or formulae to determine the working capital management of firms. A large number of factors, each having a different importance influences on working capital needs of firms. According to Pandey (2018) The following is the description of factors which generally influence the working capital requirements of a firm; Nature of business, Market Demand and Conditions,



Technology and Manufacturing Policy, Credit Policy, Availability of Credit to Suppliers and Price Level Changes

Working Capital Financing

External funds available for a period of one year or less are called short-term finance. Short-term funds are used to finance working capital. According to Pandey (2018) the following are short-term sources of financing the working capital: Trade Credit, Accrued Expenses which comprised of accrued Wages and Salaries: Accrued Taxes and Interest, Deferred Income such as Bank Borrowing, Overdraft, Cash Credit, Purchase or Discounting of Bills, Letter of Credit, Working Capital Loan, Factoring and Commercial Paper:

Importance of Working Capital

Every business needs investment to procure fiscal assets which remain in use for longer period. We call money invested in these assets long-term funds. Businesses also need funds for short-term purposes to finance current assets operations. Investment in current assets is called short-term funds or working capital. Working capital is very essential to maintain the smooth running of a business. No business can operate successfully without adequate working capital. Rafuse (2017) emphasized on the importance of maintaining adequate amount of working capital as follows:

- i. **Solvency of the business:** Adequate working capital helps in maintaining solvency of the business by providing uninterrupted flow of production.
- ii. **Goodwill:** Sufficient working capital enables a business concern to make prompt payment and hence helps in creating and maintaining Goodwill.
- iii. **Easy loan:** A concern organization, having adequate working capital, high solvency and good credit standing can arrange loan from banks and other financial institution on easy and favorable terms.
- iv. **Cash discounts:** Adequate working capital enables organization to receive cash discount on the purchase and hence it reduces costs.
- v. **Regular supply of raw materials:** Sufficient working capital ensures regular supply of raw materials and continuous production.
- vi. **Regular payment of salaries, wages and other commitments:** A company that has ample working capital can make regular payment of salaries, wages and



- other day-to-day commitments which raises the morale of its employees increases their efficiency, reduces wastages and costs, and enhance production and profits.
- vii. Ability to face crises: Adequate working capital enables an organization to face business crisis in emergencies such as depression because during such periods, generally, there is much pressure on working capital.
 - viii. Quick and regular return on investment: Every investor wants a quick and regular return on his investments. Sufficient working capital enables an organization to pay dividends regularly to its investors, as there may not be much pressure to plough back profits. This gains the confidence of its investors and creates a favorable market to raise additional funds in the future.
 - ix. High morale: Adequacy of working capital creates an environment of security, confidence, high morale and crease overall efficiency of business.

Concept of Financial Performance

Performance measurement refers to the process of measuring the action's efficiency and effectiveness (Nwude, 2017). Performance measurement is the transference of the complex reality of performance in organized symbols that can be related and relayed under the same circumstances (Lind, Michael & Wathen, 2018). In the current business management, performance measurement is considered to be in a more critical role compared to quantification and accounting (Koufopoulos, Zoumbos & Argyropoulou, 2017). This is consistent with Bititci, Carrie and McDevitt (2012) who described performance management as a process wherein the organization manages its performance to match its corporate and functional strategies and objectives.

Generally, firm performance is also referred to as financial performance. It is the result of a firm's policies and operations in monetary terms. These results are reflected in the firm's return on investments, return on assets, value added etc. It is also the level of performance of a business over a specified time, expressed in terms of overall profits and losses during that time. Evaluating the financial performance of a business allows decision makers to judge the results of business strategies and activities in objectives monetary terms. The performance can be measured in term of



profitability, liquidity, solvency, and financial efficiency among others (Agrawal, 2016).

Additionally, the firm's value can be described as the benefits stemming from the firm's shares by the shareholders (Shen & Soenen, 2016). The company's performance can be viewed from the financial statement reported by the company. Consequently, a good performing company will reinforce management for quality disclosure (Howorth & Westhead, 2016).

Measures of Firm Performance

These are valuable analytical tools that enable meaningful comparisons with other businesses and sectors, and with industry averages. The following are the measures of firm performance (Svensson, 2016).

- i. Profitability:** It measures the extent to which a business generates profit from the use of land, labour, management and capital. Some of the measures of profitability include: Net income from operation, rate of return on assets, rate of return on equity, operating profit margin. Rate of return on asset for example is a useful indicator as to whether a business is using its assets well and getting the most value out of capital expenditure.
- ii. Liquidity:** It is the ability of a business to meet financial obligation as they fall due in the short-term without disrupting the normal operations of the business. It is measured by: current ratio and quick ratio. Current ratios assess the ability of the firm to current assets into cash. Quick ratio measures a company's immediate debt-pay in ability.
- iii. Solvency:** This measures the firm's ability to pay all financial obligations if all assets are sold and with continuous viable operations after financial adversity. It is measured by: debt to asset ratio, debt to equity ratio and equity to asset ratio. Debt to asset ratio measures the percentages of a company's assets that are financed by debt. Debt to equity ratio compares creditor financing to owner financing. Solvency also measures if the total liability of a business are too high,



indicating a possible over dependency on outside sources for long-term financial support.

- iv. Financial Efficiency:** This measures the intensity with which a business uses its assets to generate gross revenues and effectiveness of production purchasing, product pricing and financial decisions. Financial efficiency is measured by; Asset turnover ratio, operating expenses ratio, depreciation expense ratio, and interest expenses ratio and net income ratio. However, financial information is the basis by which financial performance can be measured by the decision makers in judging the results of a business strategies and activities in monetary term. This financial information of any enterprise is contained in the financial statement or accounting reports (Pandey 2018). The three basic financial statements of great significance to owners, management, and investors are; balance sheet profit and loss account and cash flow statement.

Empirical Review

Mathuvia (2018) examined the influence of working capital management components on corporate profitability by using a sample of 30 firms listed on the Nairobi Stock Exchange (NSE) for the periods 2012- 2017. He made use of Pearson and Spearman's correlations, the pooled ordinary least square (OLS), and fixed effects regression models to conduct data analysis. Findings derived from his study are as follows; there exist a highly significant positive relationship between the time it takes the firm to pay its creditors (average payment period) and profitability, there exist a highly significant negative relationship between the time it takes the firm to collect cash from their customers (accounts collection period) and profitability, there exist a highly significant positive relationship between the time it takes to convert inventories into sales (the inventory conversion period) and profitability.

Raheman and Nasr (2017) examined the effect of different variables of working capital management which include; inventory turnover days. Average payment period, average collection period, cash conversion cycle and current ratio on the net operating profitability on Pakistani firms. They made use of 94 Pakistani firms listed on Karachi Stock Exchange for period of six years from 2012-2016 and found a strong negative relationship between variables of working capital management and



profitability of the firm and as the cash conversion cycle increases, profitability of the firm decreases and managers can create positive value for the stakeholders by reducing the cash conversion cycle to a possible minimum level.

Lazaridis and Tryfonidis (2017) carried out a cross sectional study by using a sample of 131 firms listed on the Athens Stock Exchange for the period of 2013-2016 and found statistically significant relationship between profitability, measured through gross profit, and the cash conversion cycle and its components (account receivables, account payables, and inventory). From the results obtained in the analysis of annual data by using correlation and regression tests, they suggest that managers can create profits for their companies by correctly handling the cash conversion cycle and its components (account receivables, account payables, and inventory) at an optimal level. Shin and Soenen (2016) used a sample of 58,985 firm's years covering the period 2007-2017 in order to investigate the relationship between net-trade cycle that was used to measured efficiency of working capital management and corporate profitability. In all cases, they found a strong negative relationship between the length of the firm's net-trade cycle and its profitability.

Therefore, managers can create value for a company by reducing inventories and the number of days for which their accounts are outstanding, their by shortening the cash conversion cycle and improving firms profitability. To achieve optimal balance and turnover of cash that maximizes the market value of the firms, companies should focus on some areas of working capital to improve marginal returns.

Padachi (2017) has examined the trends in working capital management and its impact on firm's performance for 58 Mauritian small manufacturing firms during 1998 to 2003. He explained that a well designed and implemented working capital management is expected to contribute positively to the creation of firm's value. The results indicated that high investment in inventories and receivables is associated with low profitability and also showed an increasing trend in the short term component of working capital financing.

In order to discover the relationship between efficient working capital management and firm's profitability Shin and Soenen, (2016) used net-trade cycle (NTC) as a measure of working capital management. Net trade cycle is basically equal to the cash conversion cycle whereby all three components are expressed as a percentage



of sales. The reason by using net trade cycle because it can be an easy device to estimate for additional financing needs with regard to working capital expressed as a function of the projected sales growth. This relationship is examined using correlation and regression analysis, by industry and working capital intensity. Using a Compustat sample of 58,985 firm years covering the period 1975-1994, in all cases, they found, a strong negative relation between the length of the firm's net-trade cycle and its profitability. In addition, shorter net trade cycle is associated with higher risk-adjusted stock returns. In other word, Shin and Soenen (1998) suggest that one possible way the firm to create shareholder value is by reducing firm's net trade cycle.

The study of Shin and Soenen (2016), consistent with later study on the same objective that done by Deloof (2003) by using sample of 1009 large Belgian non-financial firms for the period of 1992-1996. However, Deloof (2017) used trade credit policy and inventory policy are measured by number of days accounts receivable, accounts payable and inventories, and the cash conversion cycle as a comprehensive measure of working capital management. He finds a significant negative relation between gross operating income and the number of day accounts receivable, inventories and accounts payable. Thus, he suggests that managers can create value for their shareholders by reducing the number of days accounts receivable and inventories to a reasonable minimum. He also suggests that less profitable firms wait longer to pay their bills.

Barine (2017) analyzed the impact of WCM on the performance of non-financial companies from 4 major non-financial sectors listed on Karachi stock exchange from 2012-2016 published by the state bank Pakistan. Aim behind the study was to determine significant relation between accounting ratio and working capital management and profitability which is measured by return on equity and asset. Pearson correlation and regression results showed that there is a significant positive relationship between return on equity and asset and current assets/total assets, current ratio and quick asset debt turnover, with the exception of current asset/total sales. His results reveal that current assets/total assets, current assets/total sales, and current ratio are the strong determinants of the WCM and highest value of companies.

Narasimhan and Murty (2018) stress on the need for many industries to improve their return on capital employed (ROCE) by focusing on some critical areas such as cost



containment, reducing investment in working capital and improving working capital efficiency. The pioneer work of Shin and Soenen (2016) and the more recent study of Deloof (2017) have found a strong significant relationship between the measures of working capital management and corporate profitability. Their findings suggest that managers can increase profitability by reducing the number of day's accounts receivable and inventories. This is particularly important for small growing firms who need to finance increasing amounts of debtors.

Mauritius (country) provides a good case study for this paper as it looks at the small and medium sized enterprises operating in the manufacturing sector of a small island developing state. Most of the previous studies on working capital management and financial management of small firms have focused on the US, UK and some other developed countries like Belgium and Australia. Exchange for a period of 6 years from 2012-2017 to study the effect of different variables of working capital management on the net operating profitability. From result of study, they showed that there was a negative relationship between variables of working capital management including the average collection period, inventory turnover in days, average collection period, cash conversion cycle and profitability. Besides, they also indicated that size of the firm, measured by natural logarithm of sales, and profitability had a positive relationship.

Afza and Nazir (2017) made an attempt in order to investigate the traditional relationship between working capital management policies and a firm's profitability for a sample of 204 non-financial firms listed on Karachi Stock Exchange (KSE) for the period 2012-2016. The study found significant different among their working capital requirements and financing policies across different industries. Moreover, regression result found a negative relationship between the profitability of firms and degree of aggressiveness of working capital investment and financing policies. They suggested that managers could crease value if they adopt a conservative approach towards working capital investment and working capital financing life.

Short term financing (working capital management) is an important component of corporate finance because it directly affects both liquidity and profitability of the company. Raheman and Nasr, (2017) observed that there is a significant negative relationship between working capital (average collection period, inventory turnover in days, average payment period and cash conversion cycle) and profitability of the



firms listed on Karachi Stock Exchange. García-Teruel and Martínez-Solano (2017) found a significant relationship between SMEs' profitability and the numbers of days account receivables and days of inventory. Objective of this study is to identify the relationship between working capital management and company profitability of the manufacturing companies listed in the Colombo Stock Exchange (CSE) in order to help Sri Lankan manufacturing companies to manage its working capital more efficiently. Secondary data relating to fifteen companies from 2012 to 2016 is considered for the analysis. Pearson's correlation analysis and regression analysis are used for the data analysis. Number of days accounts receivable, Number of days accounts payable, inventory turnover in days, and cash conversion cycle are the independent variables considered in this study. Sales growth rate, fixed assets to total assets also used as control variables. The results show that there is a strong negative relationship between variables of the working capital management (Number of days accounts receivable, Number of days accounts payable and inventory turnover in days) and profitability of the firm. It means that as the cash conversion cycle increases it will lead to decrease profitability of the firm.

However, Van Horne and Wachowicz (2015) pointed out that excessive level of current assets may have a negative effect of a firm's profitability, whereas a low level of current assets may lead to lowers of liquidity and stock-outs, resulting in difficulties in maintaining smooth operations. Pandey (2018) had an attempt to study the working capital components and the impact of working capital management on profitability of Hindalco Industries Limited for period from 2010 to 2017. Results of the study showed that current ratio, liquid ratio, receivables turnover ratio and working capital to total assets ratio had statistically significant impact on the profitability of Hindalco industries Limited.

Lazaridis and Tryfonidis (2017) have investigated relationship between working capital management and corporate profitability of listed company in the Athens Stock Exchange. A sample of 131 listed companies for period of 2001-2016 was used to examine this relationship. The result from regression analysis indicated that there was a statistical significance between profitability, measured through gross operating profit, and the cash conversion cycle. From those results, they claimed that the managers could create value for shareholders by handling correctly the cash conversion cycle and keeping each different component to an optimum level.



Raheman and Nasr (2017) have selected a sample of 94 Pakistani firms listed on Karachi Stock Exchange for a period of 6 years from 2010-2016 to study the effect of different variables of working capital management on the net operating profitability. From result of study, they showed that there was a negative relationship between variables of working capital management including the average collection period, inventory turnover in days, average collection period, cash conversion cycle and profitability. Besides, they also indicated that size of the firm, measured by natural logarithm of sales, and profitability had a positive relationship.

Rafuse (2017) investigated the effect of working capital management on firm profitability, using a sample of 8,872 small and medium size European companies. They found that reducing inventory and average collection periods affect positively the firm value, as reducing the cash conversion cycle improves the firm's profitability.

Deloof (2017), in turn, carried out research on the relationship between working capital management and the performance of Belgian companies. This author used a sample of 1009 non-financial Belgian companies for the period from 1992 to 1996. He came across a significantly negative relationship between gross profits and the average period of receivables, the average period of inventories, and average period of payables. The results suggest that the managers could create value for stockholders if they were to reduce the time periods of receivables and inventories to reasonably minimum levels. These results show that there is a certain level of working capital that maximizes the value of the firms.

Theoretical Framework

The Conservative Approach

In this approach, the firm depends more on long-term funds for financing needs. In view of conservative approach to working capital management, the firm will keep a large quantity of current assets in relations to the total assets of the company. In the period when the firm has no need for temporary current assets, the idle long-term funds could be invested in tradable securities to conserve securities. The implication of this approach is that the firm has less risk of financing the problem of shortage of funds and yields a lower expected profitability resulting in a lower risk. This type of policy will also increase the company's net working capital situation.



The Aggressive Approach

In this approach, the company finances all of its fixed assets with long term capital but part of its permanent current assets with short-term credit (Van Horne and Wachowicz, 2015). Under this policy, the firm finances a part of its permanent current assets with short term financing and holds relatively small portion of its total assets in form of current assets. The implication of the aggressive approach is that it yields higher profitability resulting in a higher risk and lower working capital.

The Moderate Approach

Moderate approach helps to minimize the risk that the firm will be unable to pay off its matured obligations. The firm could attempt to match exactly the maturity structure of its assets and liabilities. Inventory expected to be sold in twenty days could be financed with twenty days bank overdraft. The implication of this approach is that it yields moderate expected profitability resulting in moderate risk, and the working capital position of the company will be in optimum balance. It is neither aggressive nor conservative but it falls in between the two policies representing moderate situations. The optimal level of working capital is reached when the degree of returns expected maximizes the shareholders wealth and it must be pointed out that there is no best working capital theory or policy to suit every organization at all times.

However, the theory that explains the effect of working capital management practice on financial performance of small and medium enterprises is the moderate approach, this is because the approach helps in minimizing the menace that the firm will be unable to pay off its mature obligation. Also the implication of this approach is that it yield moderate expected profitability resulting in moderate risk.

3. METHODOLOGY

The population of this study consist of some selected small and medium scale enterprises in Kano metropolis. According to Bank of Industry (2021), there are 468 registered small and medium industries in Kano State. This study utilizes simple random sampling technique which is one of the probability sampling methods in which the elements have an equal chance of been selected into the sample. However, sample size of this study was drawn from Krejcie and Morgan (1970) table for determining sample size. Hence, using Krejcie and Morgan, a sample size of 210



respondents was selected for the study. These respondents comprise of fashion designers, hairdressers, wood workers, electric service technicians, garage workers and photographers. More so, a structured questionnaire was used to obtain responses from the management of selected Small and Medium Enterprises in Kano Metropolis. Data obtained in this study was analyzed using Ordinary Least Square (OLS) regression to achieve the objectives of this study.

4. RESULT OF DATA ANALYSIS AND DISCUSSION

The hypotheses of this study were tested using ordinary least square regression using Statistical Package for Social Sciences (SPSS) and the results are presented in Tables

Hypothesis Testing

Inferential statistics was used in this study to achieve the objectives set out for the current study. The multiple regression techniques were also employed. The results of the hypotheses testing are summarized. The standardized path coefficient indicates whether the direction of the relationship is either positive or negative while the t-value assesses whether this relationship is significant or not (Ho, 2006; Hair et al., 2006 & Zainudin, 2014).

Hypothesis One

- H₀: There is no significant effect of cash sales on financial performance of SMEs in Kano Metropolis
- H_i: There is significant effect of cash sales on financial performance of SMEs in Kano Metropolis



Table 1: Model Summary for Cash Sales

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.814 ^a	.522	48.2	1.06724

a. Predictors: (constant) Cash Sales

Table 2. ANOVA for Cash Sales

Model	Sum of Squares	df	Mean Square	F	Sig.
1. Regression	51.022	1	51.022	57.226	.000 ^a
Residual	56.254	48	1.115		
Total	107.276	49			

- a. Predictors: (Constant) Cash Sales
- b. Dependent Variable: Financial Performance

Table 3. Coefficients for Cash Sales

Model	Unstandardized Coefficients		Standardized Coefficients		Sig.
	B	Std. Error	Beta	T	
1. (Constant)	7.234	.421	.814	22.658	.000
Cash Sales	.792	.236		7.921	.000

a. Dependent Variable: Financial Performance

The model summary gives the R-square value of 0.522 (52.22%). The R-Square, also known as coefficient of determination, measures of cash sales has been explained by financial performance The higher the R-Square, the more adequate the fitted model. The ANOVA table shows that the f – calculated is 57.226 with 1 and 48 degrees of freedom. The f – tabulated obtained from the statistical table at 0.05 level of significance of 4.08. Since, the f – calculated (57.226) is greater than the f – tabulated (4.01), the null hypothesis (H₀) is rejected and we therefore accept the (H₁) which state that there is significant effect of cash sales on financial performance of SMEs in Kano Metropolis. Finally, the coefficient table gives the nature of relationship between cash sales and financial performance. From the table, the coefficient of cash sales is 0.792. Since the coefficient is positive, this implies that There is significant effect of cash sales on financial performance of SMEs in Kano Metropolis.

Hypothesis Two

H₀: There is no significant effect of operating expenses on financial performance of SMEs in Kano Metropolis.

H₂: There is significant effect of operating expenses on financial performance of SMEs in Kano Metropolis.

Table 4. Model Summary for Operating Expenses

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.748 ^b	.700	.184	1.32583

a. Predictors: (constant): Operating Expenses

Table 5. ANOVA for Operating Expenses

Model	Sum of Squares	Df	Means Square	F	Sig.
1. Regression	21.144	1	21.144	12.028	.001 ^a
Residual	84.376	48	1.758		
Total	105.520	49			

a. Predictors (constant), Operating Expenses

b. Dependent variable: Financial Performance

Table 6. Coefficients for Operating Expenses

Model	Unstandardized Coefficients		Standardized Coefficients		T	Sig.
	B	St. Error	Beta			
1. (Constant)	7.842	.756			7.791	.000
Operating Expenses	.782	.225	.448		3.468	.001

a. Dependent Variable: Financial Performance

The model table above give R-Square value of 0.700 (70%). The R-Square, also known as coefficient of determination, measures the unevenness in Operating Expenses has been explained by financial performance. The higher the R-Square, the more adequate the fitted model. The ANOVA table shows that f – calculated is 12.028 with 1 and 48 degrees of freedom. The f – tabulated obtained from the statistical table at 0.05 level of significance is 4.08. since the f – calculated (12.028) is greater than the f – tabulated (4.08), the null hypothesis (H₀) is rejected and we therefore conclude that There is significant effect of operating expenses on financial performance of SMEs in Kano Metropolis. The coefficient gives the nature of relationship between operating expenses and financial performance is 0.782 since

the coefficient is positive, this implies that there is significant effect of operating expenses on financial performance of SMEs in Kano Metropolis.

Hypothesis Three

H₀: There is no significant effect of cash conversion on financial performance of SMEs in Kano Metropolis.

H₃: There is significant effect of cash conversion on financial performance of SMEs in Kano Metropolis.

Table 7. Model Summary for Cash Conversion

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.693 ^a	.860	.067	1.41754

a. Predictors: (contact), Cash Conversion

Table 8. ANOVA for Cash Conversion

Model	Sum of Squares	Df	Mean Square	F	Sig.
1. Regression	9.068	1	9.068	4.513	.039 ^a
Residual	96.452	48	2.009		
Total	105.520	49			

a. Predictors: (constant), Cash Conversion

b. Dependent variable: Financial Performance.

Table 9. Coefficients for Cash Conversion

Model	Unstandardized Coefficients		Standardized Coefficients		T	Sig.
	B	St. Error	Beta			
1. (Constant)	7.033	.656			10.722	.000
Cash Conversion	.439	.207	.293		2.124	.039

a. Financial Performance

The model table gave the R-Square value of 0.860 (86%). The R-Square, also known as coefficient of determination, measures the unevenness in cash conversion has been explained by financial performance. The higher the R-Square, the more adequate the fitted model. The ANOVA table give the f – calculated 4.513 with 1 and 48 degrees of freedom. The f – tabulated obtained from the statistical table at 0.05 level of significant is 4.08. Since, the f – calculated (4.513) is greater than the f – tabulated (4.08), the null hypothesis (H₀) is rejected and we therefore conclude that There is



significant effect of cash conversion on financial performance of SMEs in Kano Metropolis. Finally, the coefficient of cash conversion is 0.439 since the coefficient is positive, this implies that There is significant effect of cash conversion on financial performance of SMEs in Kano Metropolis.

5. CONCLUSION AND RECOMMENDATION

Conclusion

Working capital management refers to the management of both current assets and current liabilities efficiently and effectively. This study revealed that there is significant effect of cash sales on financial performance of SMEs in Kano Metropolis, there is significant effect of operating expenses on financial performance of SMEs in Kano Metropolis and there is significant effect of cash conversion on financial performance of SMEs in Kano Metropolis.

This study also showed that the management of SMEs plays an essential role in the day to day operation of enterprise which leads to a success or failure of a enterprise and an important aspect of corporate finance decisions. An optimal working capital management is expected to contribute positively to the creation of firm value. To reach optimal working capital management, SMEs managers should control and manage adequately each component of working capital accurately. Therefore, in order to meet the firm's objectives, which is to increase profits and create better investor value, adequate working capital should be maintained and each of its different components should be effectively and efficiently managed and control.

Recommendations

On the basis of the findings and conclusions the following recommendations are made;

- i. Financial managers should ensure that each components of working capital (account receivable, account payable, cash, inventory, and current assets) are efficiently and effectively managed to avoid waste and create value for the firms.
- ii. Owners of SMEs should maintaining relative high investment in current assets and the firm will be able to meet its short term obligations as well



- as meeting all sales order, maintain smooth production and disrupt profitability and Management should reduce the borrowing level of the manufacturing firm in order to improve credit rating, reduce the overall risk and cost of borrowing
- iii. SMES manager should maintain short cash conversion cycle and careful evaluation should be made on both short and long cash conversion cycle including the effect both has on the SMEs policy and examine the broad concept of management of working capital and realize the implication of its poor management. SMEs manager should also give credit to good customers taking into account or consideration their behaviour over time and cash discount could be given to encourage prompt payment.

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