EFFECT OF WORKING CAPITAL MANAGEMENT ON FINANCIAL PERFORMANCE OF FIVE STAR HOTELS IN NAIROBI COUNTY

ODERO BENJAMIN OKINYI

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DECLARATION

This research project is my original work and has not been presented for award of any degree in any university.

Signature…………..................………… Date…………………….....….

ODERO BENJAMIN OKINYI

D61/P/8020/1997

This research project has been submitted for examination with my approval as University of Nairobi supervisor.

Signature………………………………… Date……………………………..

MR. MIRIE MWANGI

LECTURER,

SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

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DEDICATION

I dedicate this study to my dear family members, my wife and children for all the support they

gave me all the time as I prepared and worked on this project.

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LIST OF ABBREVIATIONS

ACP ----------------- Accounts Collection Period

APP ----------------- Account Payable Period

CA -------------------- Current Assets

CL -------------------- Current Liabilities

CCC ---------------- Cash Conversion Cycle

CFO ------------------- Chief Financial Officer

COGS -------------- Cost of Goods Sold

GOP ---------------- Gross Operating Profit

GOK ----------------- Government of Kenya

ITO --------------- Inventory Turnover in Days

NPM ---------------- Net Profit Margin

PASW --------------- Predicative Analytic Software

ROA --------------- Return on Assets

ROCE --------------- Return on Capital Employed

SEA --------------- Strategic Environmental Assessment

WC --------------- Working Capital

WCM -------------- Working Capital Management

WCP -------------- Working Capital Policy

ABSTRACT

Management of working capital aimed at maintaining an optimal balance between the working capital and units such as cash receivables, inventory and payables which is fundamental section of overall corporate strategy that creates value thus important source of competitive advantage in business. For a company to operate optimally it must have a positive working capital to ensure that it is able to continue its operations and to have sufficient funds to satisfy both maturity short-term and upcoming operational expenses. In conclusion research on effect of working capital management on profitability and company's performance on five star hotels in Nairobi County has not been comprehensive thus creating a research gap that needs attention. Due to this knowledge gap, the study seeks to answer the research question of whether there exists an effect of working capital on company's financial performance on five star hotels in Nairobi County. The study sought to answer the research question of whether there exists an effect of working capital on company's financial performance on five star hotels in Nairobi County. The study establishes that possessing a lower average collection period is seen by the five star hotels as optimal, since this means that it does not take them very long to turn its receivables into cash. This owes to the fact that these hotels need cash to pay off its own expenses (such as operating and administrative expenses) including suppliers who supply food products to them on credit. They also tend to have a longer accounts payable period so as to maintain a high current ratio and avoid operating in the red. Monitoring the working capital is important for the five star hotels' cash flow and its ability to meet its obligations when they come due. However, they optimize this to ensure that their credit worthiness is not tainted, take advantage of discounts including avoiding accruing interest rates unnecessarily. The five star hotels also monitor their inventory conversion period to ensure that it is a short as possible since conversion period is negatively correlated with profitability. If conversion period is long, the five star hotels will take longer to pay off their suppliers and meet their financial obligation.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

This study add further input to business literature be looking at the effects of working capital management on the five star hotels in Nairobi county. Data on this paper will cover five star hotels licensed by hotels and restaurant authority in Nairobi County for the period 2009 to 2013.Research which have been conducted both locally and internationally have been in the relationship between working capital and financial performance of firms. Others were on the relationship between working capital and profitability. Those who carried out research on the subject are Waithaka (2012) and Mutungi (2010) who empirically examined the relationship between working capital and profitability. The founding of this study also indicates a negative relationship. This indicates that the research which has been done has not been comprehensive hence the research gap that needs attention.

1.1.1 Working Capital Management

Globally companies require effective management of working capital (WC) because it provides a financial metric which represents operating liquidity available to a business, organization or other entities which include governments. Together with fixed assets such as plant and equipment, working capital is considered as part of operating working capital. It is therefore expected that efficient management of working capital must be taken seriously so that the company can maintain its liquidity in order to meet its day to day obligations. There are some instances in which a company can be endowed with assts and profitability but it is short of liquidity if its assets cannot readily be converted into cash. It is therefore paramount for the

company to have a positive working capital so as to satisfy both maturing short term debt and upcoming operational expenses. This study seeks to test the issues touching the above in premise of the Kenyan economic landscape and in particular five star hotels in Nairobi County.

Working capital management is the most important variable in the analysis of an organization's performance. According to (Waithaka, 2012) working capital is a finance metric which represents operating liquidity available to the business entity as well as government entities. Working capital management is considered to be a managerial accounting strategy which focuses on the maintenance of efficient levels of the components of working capital, current asset, and current liabilities, in regard to each other. Efficient management of working capital confirms a company has sufficient flow that meets its short term debt obligation and operating expenses.

The implementation of effective working capital management system is a better way of hotels to improve on their earnings. Since the primary objective of the firm is to maximize on profitability and also to increase on shareholders or owners wealth, it is important to have a balance between liquidity and profitability while carrying out daily operations to ensure the smooth running as well as meeting the company's obligation (Waithaka, 2012) and (Eljlly,2012). Effective working capital management is critical in ensuring suitable growth and development of the hotel industry in Kenya in order to boost the organization's profitability.

Working capital management is critical because it directly affects the liquidity ,profitability and growth of a company hence it is important to the financial wealth of the company as the amount invested in working capital; is equally high as compared to the total assets employed

(Atril,2006). This involves planning and controlling of the current assets and liabilities in a manner that eliminates the risk of inability to meet short-term obligations and not to get into excessive investments in the assets (Lamberson, 1995). The management of short term assets is equally important as the management of long term financial assets, because it directly contributes to the maximization of a firm's profitability liquidity and total performance. Equally the firms minimize the risk in order to be able to meet its obligations when due. However increasing profitability at the expense of liquidity may expose a company to untold problems such as insolvency and bankruptcy. Inadequate working capital generally exposes the company to bankruptcy. According to (Chakraborty, 2008) too much working capital leads to waste of cash hence the decrease in profitability. Liquidity is therefore important for the operation of a company. These two objectives of the firm need to be achieved at the expense of other as both are important in a firm that does not take profitability seriously cannot survive in the long run. Similarly if it does not care about liquidity it was faced with problems of insolvency or bankruptcy. This therefore means that working capital management must be given proper consideration as it will ultimately affect the profitability of the firm.

Working capital management looks simple concept but very difficult to implement because of its complexities that surrounds the hotel industry in Kenya. In the global nature of businesses today as well as the diversity of system processes, firms measurements of performance resulted in many firms keeping excessive levels of working capital. According to (Waithaka, 2013) and (Chakraborty, 2008) free cash flow is a key influence of shareholders value and thus firms faced with difficult economic times target working capital so as to unlock cash invested in areas where there is high value added returns.

Working capital is important because it is needed to run day to day activities hence there is no organization in Kenya or anywhere in the world that does not require working capital. In an effort to maximize shareholders wealth organizations require enough earnings from their operations to earn a steady amount of profit a firm needs to be successful in its sales activities. The organization needs to invest a good portion of available funds in its current assets in order for them to convert it into cash whenever there is need because sometimes there may be time lag involved in the conversion of sales into cash. A time gap between the sale of goods and the receipt of the cash has been documented (Satyanarayana, 2011).

The importance of working capital being felt currently in order to sustain the level of sales activity. Different industries have different time lag. It is therefore evident that any decision on working capital generally affects both liquidity and profitability. Any excess investment and thus may result to poor liquidity. As I have mentioned above it is crucial that the management property manage a trade-off between liquidity and profitability in order to maximize shareholders wealth. For the purposes of understanding the effects of working capital on profitability, there is need for establishment of the relationship between the two (Satyanarayana, 2011).

Similar companies in the same industry or to compare industries or sectors in aggregation, however, there are various ways of measuring financial performance hence all measures are to be taken in aggregation. Managers can therefore control the financial affairs of a firm by using ratios. Ratios refer to the relationship between two financial balances or financial calculations which establish this studies reference in order for us to understand how best an organization is

performing financially. Ratios are also an extension of the traditional ways of measuring financial performance hence by relying on financial statements (Saliha, 2011).

1.1.2 Financial Performance

Financial performance is measured using financial matrices like profitability, liquidity, solvency, repayment capacity, short-term financial management, financial efficiency and firm over capacity. Profit means the wealth that a company has created from the utilization of its available resources (Stern, 2014). On one hand liquidity of a business determines its ability to maintain its liquid cash and cash equivalents to meet its debt obligation on a timely basis using the current ratio and quick ratio (Woodruff, 2014), Purdue (2013) describe solvency as the measure of a business ability to meet its debt obligations if all its assets are sold together with its ability to recover from financial turmoil. A company's financial performance can also be measured by how well it manages its short term financial goals for example working capital management and inventory management. On one hand financial efficiency measures the degree with which a business is using its assets in the generation of gross revenues and the effectiveness of production, purchasing product, pricing a financing decisions (Purdue, 2013).

The success of any firm in terms of performance depends on its financial objectives. The firm's financial activities can be measured in monetary terms to provide an insight in the performance of an organization as a whole. This measurement can also be used to determine the firm's overall wealth over a given time horizon.

The most recognized measures of financial performance are return on equity (ROE) and return on assets (ROA). The ROE measure earnings over a period of time on shareholders equity investment. It is also the measurement for the amount of income generated by the investment mad by an organization's owners (equity holders). The return of asset ROA measured the return on total assets after interest and taxes. It provides the management with information on the level of efficiency with which assets are financed either by debt or equity are generating after tax profits to firm.

1.1.3 Working Capital Management and Financial Performance

The profitability of any firm depends on the level of investment in current assets. However, over investment in working capital means a negative, effect on the profitability of the firm while a positive effect on the liquidity. Many studies have carried out on the relationship between the level of investment in current assets and profitability but have been found to have inverse association in the research on both micro and macro levels. In many hotels the current assets comprising inventory cash, debtors account most of the time border half of the total assets.

This is due to the fact that in hotels majority of needs depends on the level of firm's ability to meet its day to day obligations. That also means that if the firm is having low current assets it may experience shortfalls and thus difficulties in maintaining smooth running of the firm's operation (Horne and Wachewicz, 2000). For efficient working capital it must involve planning and controlling of current liabilities in such a way that it eliminates the danger of inability to meet the firm's short term obligations that have fallen due while on the other hand avoid over investment in the current assets (Eljelly, 2004).

1.1.4 Five Star Hotels in Nairobi County

Hotel industry is part of Kenya tourism sector which contributes 11% of the gross domestic product (GDP) and employing 18% of Kenya's workforce. This industry is regulated by Hotels and restaurant authority, ministry of commerce and tourism with the help of other stakeholders in the tourism sector. Examples of these are airlines, travel agents and taxi operators. The industry has been hit hard by the terrorism which resulted to the issuance of advisories which impacted negatively in the earnings and employment in the industries contributions towards GDP. However there is still hope that Kenyan vision 2030's strategy known as diversification of Kenya source markets still manage to bring in 3 million visitors into the country hence strengthening the hotel industry's earnings.

However managers of hotels small or large are expected to work with the number of visitors or clients who visited their hotels in order to generate wealth for the owners. They need also to understand the relationship between current assets and current liabilities so as to make an optimal financial decision. Researchers' has come across various theories regarding this topic but empirical methods have been inadequately focused on reaching a logical summary of the issue. The use of statistical methods in understanding this important relationship is systematically and scientifically viewed to be capable of providing better decision making (Chakraboryy, 2008).

1.2 Research Problem

Working capital management (WCM) represents operating liquidity which companies need for day to day operations. The objective is to be able to put together fixed assets such as plant and equipment because working capital is considered as part of the operating capital. The study that

was conducted in the past by Gupta (1969) Hefner (1972) indicated their decisions that were made on working capital have effects on profitability and investment and thus results on poor liquidity.

This shows clearly that companies needs to put more emphasis on working capital management in order to bridge the gap on liquidity because it is critical in the day to day running of the business. It is common for a company to be endowed with asset and profitability but it is short of liquidity if assets cannot be readily converted into cash. This again put the management in a very delicate situation in terms of working capital management. Efficient management of working capital is therefore critical for the company's success and survival as the industry needs to be strengthening in order to enhance performance and contribution to the economic growth (Pandachi, 2006).

Surprising studies that have been conducted are so few and have not addressed the issue of liquidity in companies. This knowledge gap is even more serious in the Kenya economy with few empirical attempts to understand past working capital effects on firm's financial performance.

Management of working capital aimed at maintaining an optimal balance between the working capital and units such as cash receivables, inventory and payables which is fundamental section of overall corporate strategy that creates value thus important source of competitive advantage in business (Deloof, 2013). For a company to operate optimally it must have a positive working capital to ensure that it is able to continue its operations and to have sufficient funds to satisfy

both maturity short-term and upcoming operational expenses. In conclusion research on effect of working capital management on profitability and company's performance on five star hotels in Nairobi County has not been comprehensive thus creating a research gap that needs attention. Due to this knowledge gap, the study seeks to answer the research question of whether there exists an effect of working capital on company's financial performance on five star hotels in Nairobi County.

1.3 Objective of the Study

To establish the effect of working capital management on financial performance of five star hotels in Nairobi County.

1.4 Value of the Study

Some studies which were done on working capital management in organizations had no specificity of hotels or industry as such in Nairobi County. In regard to that, hotel industry being a contributor of foreign exchange to the national grid toward the country's GDP the study was of importance to different stakeholders in the industry. The management and business owners in the hotel industry in Kenya get guidance on how working capital if managed properly will boost their business profitability. The government as the regulator of the industry was able to use the findings of the study in understanding factors that are important on the financial performance of different hotels in Kenya.

It also helped the government in establishing the modalities and regulatory measures that are needed to put in place to assist in improvement in the industry. Outcome from this study helped the government in identifying the importance of understanding correct mix of working capital which in turn helped in boosting financial performance. As the performance in hotel industry improves there was growth in GDP and thus in the entire economy of the country. The finding of this study helped potential investors in understanding the hotel industry and how to manage working capital in such a way that shareholders wealth increases. This study also added to the body of knowledge in the financial discipline and forms the basis for further research in the hotel industry and effect of management on financial performance in other sectors as well.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of literature on the effect of credit management on financial performance. It focuses on studies carried out by various scholars and theories pertaining to the effect of credit management practices and financial performance. The first theoretical review on working capital and financial performance presented followed by an empirical review of the two variables. The summary chapter is presented where a gap is identified. According to Eisenhardt (1959) an essential feature of theory building is a comparison of the emerging concepts, theory or hypothesis with extent literature.

2.2 Theories of Working Capital Management

Financing of current assets arising from current liabilities in particular the form of interest free credit from suppliers is a less expensive source of financing than equity or long-term debt capital (Van Vorne, 1995) the type of working capital policy operated was as such per factors like growth rate of the firm, its size, nature of the industry and the risk path of the organization's management. Pandey and Parera (1997) provided empirical evidence of working capital management policies and practices of the private sector manufacturing companies in Srilanka.

Anond (2001) confirmed that an individual company's investment in working capital was according to the type of industry it operates in and the essential working capital policy investment decisions is about much companies with limited resource should be invested in working capital. Decision on financing relates to how investment in working capital should be

done. What needs to be considered is an optimal level for an industry or line of business that may be detrimental to the firm either by being too high or low due to different operating on business characteristics across industries.

2.2.1 Conservative Plan Theory

The conservative plan theory mean that the cost of financing working capital is equal to the cost of long-term fund that is annual average loan multiplied by long-term rate of interest. Fixed and some part of current assets are financed by long term funds since they are permanent and long-term services are very expensive hence lower risk return (Horne and Wachowitz, 1998). Efficiency in working capital is crucial while current assets directly affect liquidity and profitability of companies. This theory is based on philosophy known as play it safe (Waithaka, 2012).

It attempts to provide enough long term financing that cover all anticipated eventualities. This theory implies high investment in current assets and turnover ratio was low. This approach does not need short- term borrowing and may be in the long run expensive because available funds may not be fully used in certain time horizon but interest on such funds are not needed may still be accrued and are paid. Rahemen and Bluementhal (1994) stated that companies are required to utilize measures on working capital even if their profitability is positive.

2.2.2 Hedging Plan Theory

Hedging theory mean no long term funds was used to finance short-term seasonal need i.e. current assets are equal to current liabilities. The theory is a moderate policy that links assets and

liabilities to maturity. Finnerty (1993; Josh et al,1996) stated that current acid test and cash ratios are balance sheet measures that cannot give a detailed and accurate working capital that is effective and efficient.

Hedging theory is a risk based theory as its full utilization on the firm's capacity to use short-term funds in an emergency situation not satisfies short-term needs. Most companies use long-term sources in financing fixed assets and permanent current assets plus short-term funds in financing temporary current assets, Richards and Laughlin(1989) Gentry et al (1990), Schillng (1996) Boer (1999) and Waithaka (2012) have insisted on utilization of ongoing liquidity management. Ongoing liquidity management means that inflows management means that inflows and outflows of cash arising from the company's as the payment and collection takes place over a period of time.

In hedging approach, a firm needs to have additional inventories for about two months and short term funds also for two months in order to match the inventory purchase. However limited access to short term WC sources which include bank financing and suppliers financing does not augur well with hedging approach. Ross et al., (2003) gave an opinion that most of them it is reasonable to study the WC management approach in reference to utilization of funds.

2.2.3 Aggressive Theory

This theory is applicable where a firm intends to take high risk and where short-term funds are used to a higher degree in financing current and fixed assets. This approach is characterized by low interest level but it is crucial to note that most companies that are operating in a stable

economy is more certain about the future cash flows. Companies operating under aggressive working capital policy after short term credit periods to customers, hold minimal inventory and thus a small amount of cash in hand. This policy in general increases risk of default as the firm may be faced with problem of meeting its short-term liabilities hence giving a high return as per its association with high risk.

2.3 Determinants of Financial Performance of Hotels

The hotels financial performance is linked to other factors which have been researched a part from ownership. According to research done in Tunisia by Sami (2014) the significance of profitability of hotels can be assessed by operational efficiency, return on assets and the firm size, indebtedness and profitability. At the microeconomic level, profit is the driving factors that enhance competition among hotels.

There are various ways in which profitability of a firm can be measured. The first one is return of asset (ROA) which is a ratio of net operating income to total assets of the hotel. ROA indicates the ability of a firm to realize return on its source of funds to generate profit. Another way to measure profitability is using return on equity (ROE) is the net operating income divided by shareholders equity. It measures how well the firm is utilizing funds invested by shareholders. The bigger the number of shareholders the larger the firms size and vice versa.

2.4 Empirical Studies

Jel (2014) investigated whether working capital management affect firm's performance of non-financial films listed in Pakistani, Kerachi stock exchange during 2007 to 2010. The impact of

WC variables was conducted using three performance measures namely gross profit margin, return on assets and return on assert and return on equity. The findings were average age of inventory was positively related to gross profit margin and return on assets but negatively related to return on equity with a significant relationship. The relationship was insignificant but positive thus may be due to increased sales which reduce inventory levels, hence profitability. Average collection period was significantly and positively related to gross profit margin and return in average collections period improves accounts receivables which in turn positively affect the firm's performance.

Mugwe (2013) examined the relationship between firm specific factors and financial between 2008 and 2012. In her research she used two measures in determining the relationship between firm's specific factors and financial performance by measuring firm's performance using return on asset (ROA) and return on equity (ROE). The finding indicates a positive significant association between financial performance and banks specific factors. The study used descriptive statistics using Pears on correlation. Also she found these correlations support the hypothesis that each independent variable in the model has own particular informative value and ability to explain financial performance. This suggests that a large number of directors positively influence the firm's operations. He found significant negative effects on the board size earning which suggests that a lean board can be more efficient.

Ngulumbu (2013) investigated the relationship between board composition and financial performance of companies listed at the Nairobi Stock Exchange formed a significant positive relationship between the board size, board committee and financial performance. This suggests

that a large number of directors positively influence the firm's operations. He found significant lean negative effects on the board size and earnings which suggests that a lean board can be more efficient.

Waithaka (2012) carried a study on the relationship between working capital management practices and financial performance specifically on companies listed at the Nairobi stock exchange. The study adopted a correlation design which allowed the collection of secondary data through structural questionnaires. The target population was individual persons and companies listed in the Nairobi stock exchange numbering seven .The data was analyzed using descriptive and inferential statistics.

The findings of the study were that there was a strong positive relationship between components of working capital management practices, Onono (2006) seek to find out how credit management practices in the service industry with specific reference to telecom Kenya limited. The study adopted the use of descriptive and inferential statistics. The findings of the study were that credit management practices were not conforming to the required practices. There were no specific provisions against each account receivables. Slow and inefficient debt collection is a factor that presented cash flow problems to the organization. The findings of the study was therefore causing a negative effect on the financial performance of the company hence the recommendation that receivable management be improved inorder for cash flow to improve also.

Mathura (2010) conducted a study on the influence of working capital management as part of corporate profitability on the listed firms in Kenya a sample of 30 firms listed at the Nairobi stock exchange (NSE) between 1993 to 2008 was considered. The pooled OLS and the food effects regression models were used to analyze the findings. The study revealed that there was a negative relationship between account collection period and profitability hence a negative effect on financial performance meaning that successful firms take a shorter time horizon to collect cash from their customers hence credit reduction. The study also reveals a significant negative relationship between the periods of inventory conversion into sales hence profitability. It is therefore clear that firms which maintain sufficiently high inventory level reduces cost of possible gaps in the production process as well as loss of business as a result of products scarcity. This also helps in the reduction of the firm supply costs as well as protecting them against prices function. The study also revealed a highly positive relationship between the time the firm takes to pay its creditors (i.e. average payment period) and profitability. This therefore means that firms that take longer time to pay its creditors remain profitable.

Wainaina (2010) conducted a study to determine the relationship between profitability and working capital on a small medium enterprise in Kenya. The study looked at a sample of 40companies whose sales turnover range between 10million and 500 million .Her study was based on companies in the ICT, general trade and construction industry. The study noted the nonexistence of relationship between cash conversion cycle and profitability for companies in the construction, ICT and transport sector. But there exists a positive relationship between profitability and cash conversion cycle for industries in the general trade and agricultural sectors. The study further revealed that there exists a positive relationship between inventory days in all

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sectors of the study. The conclusion was that a higher inventory is necessary for a higher demand hence inventory needs to be maintained at reasonable levels.

Mutungi (2010) worked on the relationship between working capital management and financial performance of oil marketing firms registered in Kenya with the petroleum institute of east Africa within Nairobi and its environs. The sample consists of 59 registered oil marketers in Kenya .The research noted that working capital management decisions have effects on the company's risk return as well as share price. The study revealed that in order for a company to operate effectively, receivables and inventory must be monitored and controlled properly. The effect of having adequate level of working capital for the growth and sustainability of a firm is therefore fundamental.

Lazaridis T. (2006) carried out a study on the relationship between the cash conversion cycle and level of profitability on 13 listed companies of the Anthens Stock Exchange for a period between 2001 and 2004 .The study aimed at determining statistically the significant relationship between CCC and profitability which is measured by operating profit. Accounts receivable turnover, accounts payable turnover and inventory management as forming part of CCC used in the study. The study revealed that firms interested in the increase in their accounts receivables to an optimal level have their profitability increased hence increase in sales and market share. The Pearson correlation and regression results were used in the analysis of the findings which revealed the existence of a negative relationship between accounts receivables turnover ,accounts payable turnover and inventory management as well as profitability which is in line with the study carried out by Deloof (2003) Belgium firms. The findings emphasized their

management of working capital has a significant effect on profitability of a firm and increase in profitability by reduction of the number of days accounts receivables as well as reduction in inventory could be beneficial to the firm.

Rahaman and Nasr (2007) carried out an analysis of the effect of various variables on net operating profitability including average collection period, average payment period ITO in days, CCC and CR in Parkistan. Control variables including debt ratio, size of the firm and financial asset over total asset ratio were used and applied. Pearson correlation and regression for purposes of data analysis. The sample of the study consisted of 94 Parkistani listed companies and the study periods were between1994-2004. The study concluded that managers can maximize shareholders wealth by efficiently managing the CCC. The study revealed a strong negative relation between the firm's profitability and measures on WCM. From this study it is clear that credit management was not proper hence negative effect on financial performance.

Truel and Solano (2007) conducted a study which a negative relationship between profitability of a company and cash conversion cycle. The finding was that there is a possibility of increasing company profitability by means of a more efficient working capital management. For this to be realized ,it is important that main components of cash conversion cycle for example short-term trade liabilities, short-term accounts receivable and inventories must be managed in such a way it maximizes a firm's profitability. An efficient working capital management increases free cash flows to the company's growth opportunities and return of stockholders. This study indicates that there is an element of negativity to some extent on the credit management hence a negative effect on the company's financial performance.

Chatraji (2010) carried out a study on the impact of working capital management on profitability in companies listed in London stock exchange between 2006 and 2008. The Pearson correlation coefficient was used by the researcher to evaluate the effect of cash transformation cycle, the period of collection of receivables, inventory retention period, liability settlement period, the current to quick ratio to net operational profit. Results indicated a negative relationship between working capital management and profitability. It therefore means that an increase in cash transformational cycle would result in a reduction in profitability. The study has also revealed a negative relationship between liquidity and profitability. This clearly indicates a negative effect on the company's financial performance.

Eljelly (2004) empirically examined the relationship between profitability and liquidity as measured by current ratio and cash gap i.e. conversion cycle using a sample of 929 on joint stock companies in Saudi Arabia. The researcher used correlation and regression analysis and the funding was a significant negative relationship between profitability and liquidity level as measured by current ratio. This relationship was found to be related to firms with high current ratios and long cash conversion cycles. At the industry level however, the finding was that the cash conversion cycle or the cash gap is of more importance as a measure of liquidity than current ratio that affects profitability. The size of the firm was also found to have negative effect on profitability at the industry level.

2.5 Summary of Literature Review

A review of the literature reveals two hypothesis. The first one supports the financial theory as well as providing evidence that increased profitability resulting in decrease inventory hence increased financial performance. There exists a positive relationship between working capital and financial performance.

Most literatures on working capital management practices point at the efficiency of cash management, receivables management, inventory management as the determinants of financial performance. Financial performance can be improved if the efficiency levels of cash, receivables and inventory management practices are considerably improved. In totality there is no doubt that efficiency in cash management, receivables management, inventory management has some influence on the growth rate of a business sales, market share, profits and total assets and thus plays a bigger role in the financial performance of a company.

Similarly the studies document a negative association between working capital and financial performance. Further studies try to explain the perceived deviation from the theory as well as proving various explanations for the phenomenon. Most of the studies attribute the negativity to the decrease in inventories where managers put emphasis on sales hence profitability.

Literature reviewed also revealed that there is a strong association between working capital management practices that has a positive impact on most organizations financial performance. However, some indicated negative relationship but the majorities enjoy good relationships and therefore on average financial performance in regard to the literature reviewed were positive hence successful management practices.

In summary the existence of a discrepancy in the literature reveal in relations to the relationship between working capital and financial performance creates a research gap that requires further studies. This research gap is compounded mostly in Kenyan situation where there is still lack of information about the relationship between working capital and financial performance.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes research methodology that was used during the time this study was carried out. The methodology presented here is grouped in the order of research design, population, data collection, data analysis and analytical models.

3.2 Research Design

The research design is the main plan of conducting the study for the purposes of achieving the stated objective. This study adopted a descriptive survey design. According to Schindler (2003) a descriptive research design is 'proper ' where the study seeks to describe characteristics of a particular group in the population and estimate the population of people with certain characteristics of a particular group in the population and estimate the population of people with certain characteristics in order to make a prediction. According to Mugenda (2003) descriptive research design is a systematic, empirical inquiry into which the researcher have no direct control of the dependent variables according to what have occurred or because the independent variable cannot be inherently manipulated.

The study has chosen the current research because it is not confined to the collection and description but seeks to establish the existence of the effects of working capital on the firm performance in relation to five star hotels in Nairobi County.

3.3 Population

The population according to Mugenda and Mugenda (2003) is an entire group of individuals, events or subjects with common observable characteristics. The population on the study was composed of Five Star Hotels in Nairobi County between the year 2009 and 2013 (Appendix 1) fulfilling the data collection criteria. The sample size consists of 15 five star hotels licensed by the Hotels a Restaurant Authority Ministry of Commerce and Tourism. The hotels financial performance as a variable was obtained from Audited Financial Statements of the hotels. The period covered is considered adequate to obtain the necessary information considering the data analysis involved.

3.4 Data Collection

The study required secondary data in meeting its obligation. Therefore secondary data collection techniques were employed in the process. The data was collected from audited financial statements and reports of the targeted companies within the study period 2009-2013with the aid of self- administered letters. A cover letter explaining the nature and benefits of the study and laid down terms of protection on confidentiality of information provided. Letters was emailed to the respondents and stated the time frame within which data was expected back. During that period a follow-up was made by telephone and emails as reminders and as a means of enhancing a higher response rate. The data was analysed to facilitate objective of the study.

3.5 Data Analysis

Data analysis involves reducing accumulated data to a manageable size, developing summaries, looking for patterns and finally applying statistical techniques. It refers to converting raw data

into meaningful information. The collected data will be examined for completeness and comprehensibility. The data will then be coded and keyed into the Statistical Package for Social Sciences (SPSS Version 17) for analysis. This is a computer aided tool for the analysis that helps to generate descriptive statistics such as means, standard deviations and percentages. It will be used in analyzing the data. The study will also employ inferential statistics such as regression and correlation to test the relationship between the selected factors influencing financial performance in solid waste management companies in Nairobi County.

3.6 Analytical Models

The study will use the following regression model.

$$ROA = \beta_0 + \beta_1 ACP + \beta_2 ICP + \beta_3 APP + \beta_4 CCC + \beta_5 CS + \beta_6 LEV + \beta_7 FFAR + \varepsilon$$

Where:

β_0=Constant term

β_n=coefficients of the variable

ROA = Return on Asset as a proxy for financial performance obtained by dividing net operating income by the total assets of each of the companies in the hotel industry.

ICP =Inventory Collection Period proxy for the inventory policy and was calculated by dividing inventory by sales and multiplying the results by 360days.

APP =Average Payable Period meaning the time it takes to settle account payables in a given period.

CS = NeuralLogarithm of the total turnover (sales)

LEV = Debt Ratio which is one of the independent variables

FFAR =Fixed Financial Assets Ratio is calculated by dividing fixed financial assets by total.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents data analysis, interpretation and discussion of the research findings. Descriptive results and those obtained from regression analysis. The statistical package for SPSS was used for both types of analysis.

4.2 Response Rate

The main objective of the study was to investigate the impact of working capital management on the financial performance of five star hotels in Nairobi County. The study targeted 15 five star hotels in Kenya and data obtained from 12 making 80% response rate. According to Mugenda and Mugenda (2003) a 50% response rate is adequate, 60% good and above 70% rated very good. This also collaborates Bailey (2000) assertion that a response rate of 50% is adequate, while a response rate greater than 70% is very good. This implies that based on this assertion; the response rate in this case of 80% is very good.

4.3 Data Validity

The efficiency ratios such as accounts receivables, inventory and accounts payable have been computed using descriptive and inferential analytical techniques to analyze the data obtained. The study used Ordinary Least Squares (OLS) regression models for the period 2009 - 2013. However, before running the regressions, descriptive statistics and correlation analysis were calculated. Correlation analysis shows the relationships between the different variables

considered in the study. The correlation matrix presented simple bivariate correlations not taking into account other variables that may influence the results.

4.4 Descriptive Statistics

The findings were presented using tables. Data from this study was collected from 12 licensed Five Star Hotels in Nairobi County for the period 2009 to 2013. The reason for choosing this market segment is primarily due to the availability and reliability of financial statements in that they are subject to the mandatory audit by recognized audit firms. The secondary data was collected from the respondents with the aid of a self administered letters. A cover letter explained the nature and benefits of the study and included request for assistance and clearly laying down terms of protection on confidentiality of information provided. After the administration of letters, a follow up was made by telephone and email reminders and as a means of enhancing a higher response rate.

The efficiency ratios such as accounts receivables, inventory and accounts payable have been computed using descriptive and inferential analytical techniques to analyze the data obtained. The study used Ordinary Least Squares (OLS) regression models. However, before running the regressions, descriptive statistics and correlation analysis were calculated. Correlation analysis shows the relationships between the different variables considered in the study. The correlation matrix presented simple bivariate correlations not taking into account other variables that may influence the results.

Table 4.1: Descriptive Statistics

	Min	Max	Median	Mean	Std. Deviation
Average collection period (days)	0.01	0.73	0.32	0.225	0.1575
Natural Log of Sales	16.45	23.48	13.14	21.3024	1.60114
Fixed Financial Asset Ratio	-0.38	1.97	0.27	0.1597	0.36099
Controls	0.27	3.85	1.68	1.2707	0.65285
Leverage ratio	0.17	2.41	0.98	1.0456	0.55042
Inventory Collection Period (days)	21.88	378.68	102.35	106.733	58.68438
Average Payable Period (days)	78.01	472.39	123.75	248.435	102.599
Cash Conversion Cycle (days)	28.13	435.08	281.85	144.393	98.99683

Source ;(Research Findings)

Table 4.1 presents the descriptive statistics and the distribution of the variables considered in this research: Inventory conversion period (ICP), average collection period (ACP), average payable period (APP), natural logarithm of the turnover (CS), cash conversion cycle (CCC), Debt ratio (LEV), Fixed Financial Asset Ratio (FFAR) and controls. And the Cash conversion cycle (CCC) The descriptive statistic considered were minimum, maximum, mean, standard deviation, skewness and kurtosis.

The table shows that the average collection period (ACP) had a mean of 0.225 and standard deviation of 0.157. That is, ACP is, on average, 22.5% of the five star hotels' (total assets – financial assets). However, the value went as high as 73% and as low as 1%. It was also noted that the Inventory Conversion Period (ICP) had a mean of 21.3024 and a standard deviation of

1.60114.The standard deviation indicated that the variance from the mean mark. The values on the inventory conversion period (ICP) went to highs of 23.48 and lows of 16.45. Mean value of average payable period was 248.4 which denotes that it averagely took the five star hotels 248 days to pay up their financial obligations. However, it took some of these hotels as short as 78 days or as long as 472 days to honor their financial obligations to other entities; in this case, their suppliers and creditors. On inventory conversion period in days, the five star hotels took, on average, 144 days to deplete their stock but this could be as short as 28 days and as long as 435 days. On average the five star hotels have a 3 days cash conversion cycle, the minimum being -241 days with a maximum of 391 days.

From the study it was noted that the controls had a mean of 1.2707 and a standard deviation of 0.65285, the standard deviation indicated the variance from the mean mark. However these values on controls went to maximum values of 3.85 and minimum values of 0.27.It was noted from the analysis that the variable (FFAR) fixed financial asset ratio had a mean of .1597 and a standard deviation of .36099.The standard deviation indicated the variance from the mean on the data collected on the fixed financial asset ratio. However these values went highs of 1.97 and lows of -.38. From the analysis it was also noted that CS which represents the natural logarithm of the total turnover (sales) had a mean of 21.3024 and a standard deviation of 1.60114 .the standard deviation calculated of 1.60114 indicated the variance from the mean mark. The CS values went highs of 23.48 and lows of 16.45 according to the five star hotels analyzed in the study.

4.5 Correlation Analysis

The study sought to establish the relationship between the WCM (working capital management) and its moderating factors on five star hotels' profitability. Pearson Correlation analysis was used to achieve this end at 99%, 95% and 90% confidence levels. The correlation analysis enabled the testing of study's hypothesis that working capital has a significant effect on five star hotels' profitability.

Table 4.2: Correlation Matrix

Variables	Y	X1	X2	X3	X4	X5	X6
Return on Asset (Y)	1						
Natural Log of Sales (X1)	.593***	1					
Leverage (X2)	0.023	-.235*	1				
Average collection period (X3)	0.1	0.007	.384***	1			
Average Payable Period (X4)	-0.119	-.404***	0.121	-.322***	1		
Invetory Collection Period (X5)	-.298**	-0.013	-.380***	-.349***	-0.068	1	
Cash Conversion Cycle (X6)	-.261**	-.283**	0.048	-.352***	0.117	.345***	1

Source : (Research Findings)

Table 4.2 illustrates significant, negative but low linear relationships between the hotels' performance and: accounts collection period (R = -0.298, p = .013); accounts payable period (R = -0.261, p = .030); inventory conversion period in days (R = -0.301, p = .012); and, cash conversion cycle (R = -0.169, p = .016).

4.5.1 Effect of Accounts Collection Period on Profitability

The first objective of this study was to determine the relationship between accounts collection period and five star hotels' profitability. This objective was tested using the first hypothesis; that ineffective average collection period has a negative impact on five star hotels' profitability. The study's established negative coefficient between accounts collection period and profitability ($p = 0.013$) points at rejection of the null hypothesis of insignificant relationship. This depicts that five star hotels that are not efficient in collecting debts from sales are less profitable suggesting that an increase in ACP will have negative impact on return on assets.

4.5.2 Effect of Average Payable Period on Profitability

The second objective of this study was to ascertain the relationship between accounts payable period and the five star hotels' profitability. This objective was tested using the second hypothesis *H2* which stated that there is no relationship between accounts payable period and the hotels' profitability. The study established a significant negative coefficient ($p = 0.030$) between average payable period and profitability. Thus, the null hypothesis is rejected and alternative hypothesis of significant relationship accepted. This depicts that less profitable hotels wait longer to pay their bills.

4.5.3 Effect of Cash Conversion Cycle on Profitability

In order to establish the relationship between cash conversion cycle and five star hotels' profitability as per the third objective of the study, the third hypothesis *H3* was tested. *H3* stated that longer cash conversion cycle has insignificant decrease on five star hotels' profitability. The study established a negative coefficient significant ($p = .016$) at $\alpha = 5\%$. Thus, the null hypothesis

is also rejected. This implies that if these hotels are able to decrease their cash conversion cycle (daily sales, collection of debts and deferred payment of financial obligations), it can improve its operating profitability.

4.5.4 Effect of Inventory Conversion Period (ICP) in days on Profitability

The last objective of the study was to establish the relationship between inventory turnover in days and five star hotels' profitability and was tested by the fourth hypothesis. *H4* stated that the hotels' profitability is insignificantly negatively influenced by the inventory turnover days. The study established a negative coefficient between inventory turnover period in days and profitability ($p = .012$). The null hypothesis is, thus, rejected and alternative hypothesis of significant relationship accepted. This suggests five star hotels that hold much inventory are less profitable. That is, when the time span during which inventories remain within these hotels increases, profitability decreases.

***. Correlation is significant at the 0.01 level (2-tailed); **. Correlation is significant at the 0.05 level (2-tailed).

*. Correlation is significant at the 0.10 level (2-tailed).

4.6 Regression Models

Regression analysis was used to measure the relationship between individual independent (average collection period, average payable period, inventory conversion period in days and cash conversion cycle, debt ratio(LEV),FFAR(Fixed financial Asset Ratio),controls) and dependent variable (Return on Assets). The regression analysis was of the form: $ROA = \beta_0 + \beta_1 (ACP) + \beta_2 (ICP_{it}) + \beta_3 (APP_{it}) + \beta_4 (CS_{it}) + \beta_5 (LEV_{it}) + \beta_5 controls + \varepsilon_i$

Whereby ROA is return on assets, (ACP) is average collection period; ICP is the inventory conversion Period, (APP) average payable period, (CS) neural logarithm of the total turnover,(LEV) is the debt ratio, β_0 is regression constant, β_0 to β_5 is regression coefficients and εi is model's error term.

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.636[a]	.405	.352	.12906	1.915

Source: Research Data, 2013

4.6.1 Model Summary

Determination coefficients (R^2) were also carried out to determine the strength of the relationship between independent and dependent variables. The study established R^2 of 0.8368. R^2 of 0.8368 indicates that 83.68% of the variation in financial performance of private solid waste management company in Nairobi County is attributed to changes in the explanatory variables. The Durbin-Watson test statistic tests the null hypothesis that the residuals from an ordinary least-squares regression are not auto correlated. The Durbin-Watson statistic ranges in value from 0 to 4. A value near 2 indicates non-autocorrelation; a value toward 0 indicates positive autocorrelation; a value toward 4 indicates negative autocorrelation. Since the DW value of 1.8992 was close to 2, then it can be concluded that there was no autocorrelation among the model residual.

Table 4.4: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	.634	5	.127	7.616	.000[b]
1	Residual	.933	56	.017		
	Total	1.567	61			

Source: Research Data, 2013

4.6.2 Analysis of Variance

The study used ANOVA statistics to establish the significance of the relationship between financial performance and the explanatory variables. The regression model is significant given the level of significance 0.000 ($p = .025$) which is below 0.05, therefore there is statistical significant difference between the means of the dependent and explanatory variables.

4.6.3 Regression Coefficient

Table 4.5: Coefficients model

	B	Std. Error	Beta	T	Sig.
(Constant)	-0.391	0.274		-1.428	0.155
Average Collection					
Inventory Conversion		0.046	-0.317	-6.531	0.000
Average Payable					
Cash Conversion	0.386	0.059	0.331	6.557	0.000
CS(Natural					
R	0.169	0.072	0.111	2.334	0.021
R-squared	0.046	-0.317	-6.531	0.000	0.725
Adjusted R-squared					
Durbin-Watson	-0.208	0.057	-0.194	-3.646	0.000

Dependent   Variable: Tax

compliance

Source: Research Data, 2013

***. Significant at the 0.01 level; **. Significant at the 0.05 level; *. Significant at the 0.1 level

Dependent Variable: Return on assets

R value in Table 4.5 denotes the correlation coefficient between dependent and independent variables; that is, if there is a linear relationship and the nature of the relationship if at all exists. Coefficient values 0.679, 0.636, 0.636 and 0.635 were established in first to fourth regression models respectively. This illustrates a good relationship between Return on assets and working capital management especially average collection period.

R-square values present the strength of the relationship between profitability and independent variables. From the adjusted determination coefficients, generally moderately strong linear relationships were established between dependent and independent variables. Adjusted R-square values between 0.349 and 0.412 were established. Their R-squared are higher reflecting the increased explanatory power of model. The study also used Durbin Watson (DW) test to check that the residuals of the models were not auto-correlated since independence of the residuals is one of the basic hypotheses of regression analysis. Being that the DW statistics were close to the prescribed value of 2.0 for residual independence, it can be concluded that there was no autocorrelation.

Analysis of Variance's (ANOVA) f-test was used to make simultaneous comparisons between two or more means; thus, testing whether a significant relation exists between variables (dependent and independent variables); thus, helping in bringing out the significance of the regression model. Since the values were below 0.05, it can be concluded that the regression models were significant. Predictors: (Constant), Debt Ratio (LEV), Average Collection Period (ACP), Average Payable Period (APP), Inventory conversion Period in Days (ICP), Cash

Conversion Cycle (CCC) and (CS) Natural logarithm of total turnover, and (FFAR) fixed financial asset ratio.

Table 4.3 shows that the regression coefficients of independent variables and in this case working capital management were significant: average collection period, inventory conversion period in days and cash conversion cycle at 95% confidence level, while average payable period at 90% confidence level. Natural log of total turnover, LEV, FFAR and controls all show positive coefficient, however only the first two, that is, Natural log of total turnover and LEV are significant at 90% and 99% level respectively. In particular, the coefficient of the average collection period is negative and is highly significant at $\alpha = 5\%$, indicating that an increase or decrease in the number of days of accounts receivable will significantly affect profitability. The R-squared, which represents the proportion of the overall variance explained by the variables included in the equation model, is 46% with an F-value of 9.558 which is highly significant $\alpha = 1\%$.

Similar evidence is found by Gill et al. (2010), who did research in the USA and found a highly significant negative relation between accounts receivables and a firm's profitability in which they suggest that firm can enhance their profitability by keeping their working capital to a minimum. They argue that less profitable firms will pursue a decrease of their accounts receivables in an attempt to reduce their cash gap in the cash conversion cycle. This result can therefore be interpreted to imply that the less the time it takes for customers to pay their bills, the more cash is available to replenish inventory, hence the higher the sales realized leading to higher corporate profitability. This finding contradicts the result of a negative relationship found

in articles, such as Deloof (2003), Lazaridis and Tryfonidis (2006), Garcia-Teruel and Martinez-Solano (2007), and Raheman and Nasr (2007). The findings are however consistent with that of Mathuva (2010) who found a positive evidence in Kenya. He argued that firms keep higher levels of inventory to minimize the risk of possible production stoppages or when a firm has temporarily no access to products of sale.

4.7 Discussion of Research Findings

The study establishes that possessing a lower average collection period is seen by the five star hotels as optimal, since this means that it does not take them very long to turn its receivables into cash. This owes to the fact that these hotels need cash to pay off its own expenses (such as operating and administrative expenses) including suppliers who supply food products to them on credit. They also tend to have a longer accounts payable period so as to maintain a high current ratio and avoid operating in the red. Monitoring the working capital is important for the five star hotels' cash flow and its ability to meet its obligations when they come due. However, they optimize this to ensure that their credit worthiness is not tainted, take advantage of discounts including avoiding accruing interest rates unnecessarily. The five star hotels also monitor their inventory conversion period to ensure that it is a short as possible since conversion period is negatively correlated with profitability. If conversion period is long, the five star hotels will take longer to pay off their suppliers and meet their financial obligation. These study findings are in line with Ding, Guariglia and Knight (2012) who asks whether good working capital management can make a difference in keeping fixed investment for firms even if when firms have cash flow fluctuation and financial constraints. They expound this question by using panel data of a sample of 116,000 Chinese firms of different ownership for the period 2000-2007.

The study exhibits that those non-state owned firms have sensitivity of investment to cash flow, indicating that firms suffer from financial constraints. They also found out that even though with financial constraints, firm with high working capital has lower sensitive of fixed capital investment to cash flow, suggesting an efficient WCM can help firms to relieve the pressure of financing constraints. Moreover, the findings are supported by Garcia-Teruel and Marinez-Solano (2007) who affirmed in their study the importance of working capital management to corporate profitability by providing empirical evidence on the effects of working capital management on the profitability of Spanish firms. They demonstrated in their study how managers can improve profitability by shortening the cash conversion cycle through inventory reduction and reduction in the outstanding number of day's receivables.

The third column of Table 4.3 presents the estimation results from model III with Average Payables Period (APP) used as a measure of working capital management (independent variable). The other variables are the control variables used in previous regressions model I and II. The coefficient of APP is negative and significant at $\alpha = 1\%$. The negative relationship between the APP and Return on assets (ROA) is consistent with studies conducted on working capital management and profitability by Eljelly (2004), Deloof, (2003), Lazaridis and Tryfonidis, (2006), and Garcia-Teruel and Martinez-Solano (2007) and Raheman and Nasr (2007) in which they have made an interpretation to the effect that less profitable companies wait longer to pay their bills. This finding however differs with that of Mathuva (2010) who found a positive relation between accounts payables and firm's profitability in Kenya. According to Mathuva (2010), he argued that this is because profitable firms wait longer to pay their bills and firms use

these short-term loans as a source of funds to increase their working capital investment and thus increasing their profitability.

The adjusted R-squared is 35% and The F-Value is significant, with a value of 7.616. In the fourth model, we used the same control variables as in the previous models, and Cash Conversion Cycle as an independent variable. This model shows that the relationship between the Cash Conversion Cycle and Return on Assets (ROA) is negative and statistically significant at the level of 1%. This is in line with previous research studies on working capital management conducted by Raheman and Nasr (2007), Zariyawati et al. (2009), Falope and Ajilore (2009), Dong and Su (2010), Mathuva (2010) and Quayyum (2012) who did research in Pakistan, Malaysia, Nigeria, Vietnam, Kenya and Bangladesh respectively. All these studies also found a significant negative relationship between the cash conversion cycle and the hotels' profitability. This finding implies that decreasing the cash conversion cycle will positively affect profitability. This result can be interpreted to mean that managers can create value for their firms, by keeping their working capital to a reasonable minimum. The other variables in the model have almost the same signals as in previous regressions. This can be attributed to the fact that government owned five star hotels are occasionally bailed out of operating efficiently by the government coupled with bad corporate governance that rarely look into its working capital. A unit change in cash conversion cycle influenced profitability by -0.00006 among privately owned five star hotels compared to -0.000106 among government owned sugar firms.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter presents summary discussions of the key findings presented in chapter four and conclusions drawn based on such findings and recommendations. This chapter will thus be structured into conclusion, recommendations and areas for further research.

5.2 Summary of Findings

The study establishes that possessing a lower average collection period is experienced by the five star hotels as optimal, because it means that it take them shorter period to turn its receivables into cash. This is due to the fact that these hotels are in need of cash to pay off their expenses (such as operating and administrative expenses) including suppliers who supply food products to them on credit. They also tend to have a longer accounts payable period so as to maintain a high current ratio and avoid operating in the red. They are able to monitor the working capital as an important factor for the five star hotels' cash flow and their ability to meet obligations when they come due. They are also optimizing this to ensure that their credit worthiness is not tainted, take advantage of discounts including avoiding accruing interest rates unnecessarily.

These findings are supported by Garcia-Teruel and Marinez-Solano (2007) who affirmed in their study the importance of working capital management to corporate profitability by providing empirical evidence on the effects of working capital management on the profitability of Spanish firms. They demonstrated in their study how managers can improve profitability by shortening the cash conversion cycle through inventory reduction and reduction in the outstanding number

of day's receivables. Smith (1973) noted that the failure of a large number of firms can be attributed to inefficient WCM due to the inability of financial managers to properly plan and control WC. WC is commonly understood as the fund needed to meet the day-to-day expenses of an enterprise. Technically, it is defined as the difference between a firm's current assets and liabilities (Guthman and Dougall 1948; Park and Gladson, 1963; Bhattacharya 2009). In Deloof (2003), Planware (2010) and Lukkari (2011), the major measures of WC indicated include: number of days inventories are turnover, account receivable and payable; current ratio (CR); quick ratio; WC ratio; net liquidity balance; WC requirement; and the CCC, first introduced by Gitman (1974) and later refined by Gitman and Sachdeva (1984).

The CCC captures the time lag between the expenditure for the purchase of raw materials and the collection from the sale of finished goods (Shin and Soenen 1998). Longer cash cycle means more investment in WC while shorter cycle implies otherwise. Reducing the CCC to a reasonable minimum generally leads to improved profitability, but in some cases longer cash cycle might increase profitability because it leads to higher sales (Deloof 2003).

5.3 Conclusion

From the results, possessing a lower average collection period is seen by the five star hotels as optimal, since this means that it does not take them very long to turn its receivables into cash. This owes to the fact that these hotels need cash to pay off its own expenses (such as operating and administrative expenses) including suppliers who supply food products to them on credit. They also tend to have a longer accounts payable period so as to maintain a high current ratio and avoid operating in the red. Monitoring the working capital is important for the five star

hotels' cash flow and its ability to meet its obligations when they come due. However, they optimize this to ensure that their credit worthiness is not tainted, take advantage of discounts including avoiding accruing interest rates unnecessarily.

The five star hotels also monitor their inventory conversion period to ensure that it is a short as possible since conversion period is negatively correlated with profitability. If conversion period is long, the five star hotels will take longer to pay off their suppliers and meet their financial obligation. The hotels' operations were choked owing to lack of space and too expensive logistics such as wastage of perishables. In summary, the findings from this study suggest that hotels can improve their profitability by reducing their cash conversion cycle. These findings are generally in line with many previous studies done on working capital management such as those of Raheman and Nasr (2007), Deloof (2003), and Mathuva (2010).

5.4 Recommendations

Based on the findings and results from the analysis of the study, a general recommendation would be for the five star hotels to seriously rethink their corporate financial management practices in order to boost their growth and subsequently create value for shareholders. This can be achieved by taking specific actions in the following areas;

Whereas it is observed that on average, most of the five star hotels took between 107 days to collect receivables, at certain periods, some five star hotels had to wait for as much as 379 days to realize the same, yet still others managed to achieve this in as short as 22 days. The negative relationship found between the five star hotels' profitability and average collection period

indicates that firms will experience increased profitability if there is a decrease in collection period of account receivables. The hotels must therefore seek to adopt a neither liberal credit nor conservative policy so as to minimize bad debts and maximize sales in order to increase their profitability.

Though the five star hotels were found to keep high accounts payable turnover ratio, it is not always in the best interest of these hotels. Many of these five star hotels extend the period of credit turnover to over one year and this may lead to a situation where the firm faces insolvency and that such hotels may be operating below par in terms of current assets. On inventory conversion period in days, the five star hotels took, on average, 144 days to make total sales but this could be as short as 28 days and as long as 435 days. Whereas the study found positive relationship between inventory conversion period in days and the hotels' profitability, it can be noted that in as much as maintaining higher inventory ensures firm has sufficient stock that might result in more sales, the practice also attracts costs like storage, carrying, spoilages, insurance, and opportunity cost. On the other hand keeping low inventory may result in high liquidity.

As a result, five star hotel managers have to adapt proper inventory control techniques such as economic order quantity (EOQ), depending on the nature of inventory they hold. Furthermore, the firms must create stronger linkage between stores, purchasing and marketing departments that enhances communications thereby providing each other with the relevant information that positively helps the firm in managing its inventory operations and minimizing costs.

5.5 Limitations of the Study

The study focuses on five star hotels in Nairobi County. The results are therefore applicable only to five star hotels in Nairobi County and therefore any attempt to generalize the findings to other areas and or segments outside this scope should be approached with a lot of care. The analysis covered only five Star Hotels licensed by Hotels and Restaurant Authority in Nairobi County and this in itself limit the findings that could have been realized if the entire hotel industry were included in the study.

The population size could have affected the results and thus the findings should not be presumed to be certain. The time taken during the study was also not sufficient enough to get through the details and analysis of the study perfectly well due to data involved. With enough time, detailed tests could be carried out to establish whether the conclusion derived when variables in question were more could have been different.

There are other factors that may impact negatively on financial performance and thus working capital management (WCM) should be looked at in terms of non-financial and financial factors. With this in mind, more studies that incorporate other factors which may affect financial performance as well as working capital management would be objective enough and helpful to the management of five star hotels in Nairobi County.

5.6 Suggestions for Further Research

This study can be a replica in the entire hotel industry in establishing a more prudent way in which working capital management can be viewed in terms of increasing the company's

financial performance thus profitability. Good management of working capital helps companies to have liquid cash and thus be able to meet their obligations as they fall due. Also a consideration as to whether non - financial performance can affect efficiency of working capital management is another area that needs to be looked at seriously.

The study suggests that similar studies should be done on other firms as the relationship adduced does not conform to the rule of thumb or one-size-fits-all mantra as different industries and sector have different operational environment. This might affect the relationship between working capital and profitability.

There is need for further studies to carry out similar tests for a longer time period of time. This will help in observing the five star hotels and the relationship between working capital management and profitability through to the earlier periods before liberalization when the five star hotels had little competition and were subjected to political patronage with little accountability.

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Appendix I: Descriptive Data

Five Star Hotels.	Year	Net Income	CS(log. turnover)	Sales Growth	CR	(LEV)Debt Ratio	ACP	APP	ITO	CCC
The sarova Stanley	2009	0.4011	22.755		1.494	0.272	33.11	85.49	82.65	30.27
Nairobi Serena Hotel	2009	0.1551	21.600		1.968	0.374	138.65	359.74	124.69	-96.41
The Intercontinental	2009	0.2009	21.611		0.406	0.872	115.87	313.87	123.86	-74.14
Fairmont the Norfolk	2009	0.3573	20.880		1.021	0.954	153.69	350.62	57.37	-139.56
Winsor Golf	2009	0.0896	21.264		1.222	0.542	129.02	156.57	80.22	52.68
Vila Rosa kempinski	2009	0.0080	16.453		1.663	1.156	157.63	272.45	424.78	309.97
The sarova Stanley	2010	0.5282	23.005	0.2836	1.409	0.170	36.58	87.82	52.71	1.48
Nairobi Serena Hotel	2010	0.2790	21.830	0.2587	1.778	0.412	112.34	364.43	163.02	-89.07
The Intercontinental	2010	0.2223	21.694	0.0862	0.434	1.086	83.57	334.95	156.83	-94.55
Fairmont the Norfolk	2010	0.3086	20.825	-0.0538	0.979	1.138	127.25	263.82	67.00	-69.56
Winsor Golf	2010	0.1441	21.486	0.2487	1.154	0.647	114.19	228.17	87.45	-26.53
Vila Rosa kempinski	2010	0.2278	20.630		1.534	1.158	150.93	217.54	96.08	29.47
The sarova Stanley	2010	0.0073	16.489	0.0370	1.172	1.152	127.09	356.78	435.08	205.39

The sarova Stanley	2011	0.4517	23.034	0.0294	2.416	0.193	38.77	78.01	36.63	-2.61
Nairobi Serena Hotel	2011	0.1912	21.664	-0.1530	1.626	0.447	106.71	302.33	189.99	-5.63
The Intercontinental	2011	0.1280	21.635	-0.0573	0.846	1.277	74.42	197.75	127.78	4.45
Fairmont the Norfolk	2011	0.2743	20.854	0.0301	0.948	1.316	79.92	420.75	163.23	-177.59
Winsor Golf	2011	0.1947	21.598	0.1187	1.100	0.599	111.79	221.93	93.98	-16.17
Vila Rosa kempinski	2011	0.2209	20.990	0.4334	2.226	1.002	78.98	98.97	84.73	64.73
The Boma	2011	0.0096	16.791	0.3522	0.905	1.670	98.25	297.92	334.67	135.01
Panari Hotel	2011	0.4683	23.179	0.1565	2.179	0.351	44.30	110.41	33.87	-32.24
The sarova Stanley	2012	0.2076	21.780	0.1233	1.394	0.471	119.01	362.05	228.05	-14.99
Nairobi Serena Hotel	2012	0.1767	21.577	-0.0562	0.385	1.596	172.22	274.75	197.16	94.63
The Intercontinental	2012	0.4199	21.387	0.7028	0.974	1.067	134.14	323.05	103.75	-85.16
Fairmont the Norfolk	2012	0.2072	21.592	-0.0063	0.698	0.943	143.47	266.21	119.42	-3.32
Winsor Golf	2012	0.3928	21.332	0.4072	1.265	1.339	27.42	258.31	157.08	-73.80
Vila Rosa kempinski	2012	0.0136	17.880	1.9719	3.438	1.479	46.86	260.28	68.21	-145.21

The Boma	20 12	0.3815	23.063	-0.1095	2.2 79	0.300	74. 34	81. 98	28. 13	20.5 0
The Sarova Stanley	20 13	0.0783	21.640	-0.1306	1.3 70	0.460	124 .68	221 .60	181 .39	84.4 7
Nairobi Serena Hotel	20 13	0.0989	21.613	0.0365	0.2 70	1.459	160 .16	266 .05	142 .18	36.2 9
The Intercontine ntal	20 13	0.1774	21.074	-0.2687	0.9 39	1.166	173 .29	362 .60	130 .47	- 58.8 5
Fairmont the Norfolk	20 13	0.1278	21.451	-0.1313	1.0 58	0.692	142 .50	317 .47	211 .24	36.2 7
Winsor Golf	20 13	0.2471	21.179	-0.1419	1.4 61	1.165	128 .34	316 .71	269 .14	80.7 7
Vila Rosa kempinski	20 13	0.0170	18.097	0.2427	1.4 81	1.315	43. 36	311 .06	112 .58	- 155. 12
The Boma	20 13	0.3782	23.206	0.1531	1.3 46	0.361	80. 23	133 .91	51. 57	- 2.11

Appendix II: List of Five Star Hotels in Nairobi County

1. Fair View Hotel

2. Silver Spring Hotel

3. Intercontinental Hotel

4. Utalii Hotel

5. Sarova Stanley Hotel

6. Nairobi Safari Club Hotel

7. Panari Hotel

8. Safari Park Hotel

9. Sarova Pan Africa Hotel

10. Southern Sun Mayfair Hotel

11. Nairobi Serena Hotel

12. Laico Regency Hotel

13. Boma Hotel

14. Vila Rosa

15. Fairmount Norfolk Hotel