

**EFFECT OF WORKING CAPITAL MANAGEMENT POLICIES ON
PROFITABILITY AMONG THE CUT FLOWER COMPANIES IN
KENYA**

**BY
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DECLARATION

By signing here, I affirm that the work presented here is entirely my own and that it has not been previously published or submitted for review at any other institution except the University of Nairobi.

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D61/5269/2017

Date: 8/12/2022

This research project has been sent in for evaluation, and I, in my capacity as University Supervisor, have given my permission.

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Last but not least, I want to express to my family all of the love I have for them and my profound appreciation for the unwavering love and support they have shown me throughout my life. They encouraged my passion to learn and provided me with the chance to further my education. For the rest of my life, I shall have the deepest and most genuine affection for them.

DEDICATION

I dedicate this work as a sacrifice to God Almighty, the one who made me, the rock upon which I lean, the fountainhead of all my creativity, insight, and comprehension.

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ABBREVIATIONS AND SYNONYMS

ACP	-	Average Collection Period
AFP	-	Aggressive Financing Policy
AIP	-	Aggressive Investment Policy
APP	-	Average Payables Period
ASE	-	Amman Stock Exchange
CCC	-	Cash Conversion Cycle
EVA	-	Economic Value Added
GDP	-	Gross Domestic Product
ICP	-	Inventory Conversion Period
JIT	-	Just In Time
NSE	-	Nairobi Securities Exchange
NTC	-	Net Trade Cycle
ROA	-	Return on Asset
ROE	-	Return on Equity
SMEs	-	Small and Medium Enterprises
SPSS	-	Statistical Package for the Social Sciences
WCFP	-	Working Capital Financial Policy
WCM	-	Working Capital Management

ABSTRACT

The core business activities of every organization are the root cause of its financial success. The company's day-to-day operations are impacted by management's choices on working capital, which includes inventories, short-term loans, accounts payables, and receivables. This research looks at how different types of cut flower companies in Kenya handle their working capital and how it affects their bottom line. The return on assets was used as the performance indicator, with the working capital management variables of average collection time, inventory turnover, accounts payables period, and cash conversion cycle all being used. The return on investment was another metric used to evaluate company success (CCC). Secondary data from 85 cut flower companies in Kenya. This research uses a variety of statistical methods, including Pearson's Bivariate Correlation, multiple regression, and analysis of variance, to get the conclusion that WCM has a significant effect on the financial results of the businesses studied. Both the ACP and CCC demonstrated statistically and practically significant negative correlations with ROA (ROA). A negative link was found between ICP and ROA, while a positive correlation was found between APP and ROA, however neither association was statistically significant. However, these two pairings were diametrically opposed to one another. These results suggest that reducing ACP, CCC, and ICP would significantly increase ROA for manufacturing firms. The combined effects of the ACP, ICP, APP, and CCC were shown to explain 37.2% of the variation in ROA between businesses in the regression analysis. WCM was shown to be consistent with value maximization and value seeking. Management should regularly evaluate the impact of working capital on profitability in order to optimize shareholder value. No matter how large or profitable a company is, or how diverse its assets may be, managers know that they must have a steady supply of working capital if they want to maintain operations and develop their business.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Working capital management (WCM) is an essential element of corporate finance that plays an important part for an entity's survival and creation of shareholders value (Vijayakumaran, 2019). Working capital combines short-term finance management with strategic business decisions that affect profitability, risk and, subsequently, the value of the company, even for companies with positive long-term prospects (Gomes, 2013). WCM efficiency helps to improve a company's free cash flow, leading to increased company growth opportunities and maximizing shareholder returns (Shajar, 2017). By effectively managing working capital accounts, companies can maximize profitability and minimize related risks (Gomes, 2013). WCM that works properly improves a company's bottom line and cash flow, which in turn raises its stock price.

This study shall be guided by the trade credit theory, the tradeoff theory and the operating cycle theory. As per the trade credit hypothesis, a company may make a purchase from another company without having to pay for it in full up front with cash or a check because of trade credit channels leading to accounts payable and receivable (Yazdinejad & Jokar, 2019). Investment in working capital, according to the tradeoff theory, requires balancing risk and profitability; actions that boost performance don't often boost the odds of achieving a suitable liquidity level, while decisions that merely maximize liquidity do the opposite (Gomes, 2013). The operating cycle theory argues that the management of receivables, payables, inventories, and cash is essential to a company's operational functions (Sorin & Nucu, 2021).

The agriculture industry is an important part of Kenya's economy since it accounts for around 25 percent of the country's total GDP and gives those living in rural areas a means to support themselves (Muturi, 2019). On the other hand, data from the NSE indicate that the stock of the agricultural sector has decreased over the course of the last several years, in contrast to the stock of other market sectors, whose prices have been gradually increasing. In addition, the industry works with items that are susceptible to weather, and the Kenyan market is characterized by climate circumstances that are unusually unpredictable. This fact is mirrored in the unpredictability of the company's earnings in the agricultural sector in Kenya (Oruko & Tibbs,

2020). Kenya's cut flower industry has been growing at a steady clip in recent years, both in terms of land area and total annual sales. According to Bolo (2006)'s estimates, the industry is one of the fastest-growing in the globe, expanding by 200 hectares each year. Over 60 percent of the country's horticulture sub-sector is involved in this business, and it generates between one and eight percent of the country's total export revenue and approximately 1.5 percent of the country's GDP.

1.1.1 Working Capital Management Policies

A company's risk and return behavior may be influenced by its working capital management rules, which provide guidelines for making choices on the short-term liabilities and assets of the business (Hossain, 2020). Two policies, WC investment policy and WC finance policy, are used to control working capital (Quy, 2017). The financial policy is the choice of how much investment will be undertaken using short-term resources and how much will be financed with non-current resources (Tewdros, 2010). An accounting of how much of the firm's liquid assets have been put to use in various investments may be found in the investment policy. Investing replicates conservatism when an entity invests a larger portion of its funds in cash, while in an aggressive approach the entity invests less in working capital (Shajar, 2017).

The aim of WCM is to guarantee that the company can cover its operating costs and remain able to meet short-term liabilities once they become payable (Shajar, 2017). The firm WC policy determine the amount of cash, temporary investments, stocks and receivables that are held. The inability to develop a solid policy will threaten the company's continuity and survival (Almomani, Almomani & Obeatat, 2021). Financial health may be assessed more accurately via the lens of WCM. In analyzing a company's financial health, creditors and investors always look to the company's share capital as a leading sign (Hoang, 2015). Effective WCM plays a significant role in the corporations overall strategy maximizing shareholder's value (Vijayakumaran, 2019).

The purpose of WCM is to guarantee that day-to-day operational expenses are covered and that immediate debts are paid when they come due (Sianipar & Prijadi, 2019). The aggressiveness or conservatism of WCM's investing and financial policies might be evaluated (Roni, Djazuli & Djumahir, 2018). Aggressive investment policy (AIP) means minimal investment in working

capital as part of total assets, while conservative IP means more investment in cash. Aggressive financing policy (AFP) uses a higher short-term debt level, while conservative financing uses more long-term debt (Quy, 2017). The ratio of current assets to total assets and the ratio of current liabilities to total assets might indicate a company's working capital investment and financing strategies, respectively (WCFP).

1.1.2 Firms Profitability

Profitability denotes the corporation's ability to make a profit from all its activities. Profit emanates from the sales or income after deducting all costs, comprising debt interest and taxes (Prempeh, Sekyere & Amponsah, 2017). Each and every profit-driven business must measure its success by its capacity to turn a profit (Roni, Djazuli & Djumahir, 2018). The company's profitability arises from its aptitude to use resources proficiently and efficiently to create revenue (Hoang, 2015). Profitability is a vital indicator of a company's performance that indicates better returns for investors (Hossain, 2020). The capacity to earn a profit is an indication of how well a business manages its resources so as to maximize the return on investment for its shareholders (Endri, 2020).

In order for a business to thrive and succeed over time, profitability is an absolute need. Furthermore, profitability significantly affects the achievement of other financial objectives of the organization (Fareed et al., 2016). In a highly competitive market, a company's profitability is an essential measuring stick for growth and development decisions (Yussuf, 2019). Profitability is a key measure of the performance of most companies. In general, profitability becomes an indicator of the success of managers in achieving business goals (Roni, Djazuli & Djumahir, 2018). High profits are a sign that the company is using its resources efficiently. The company's ability to grow profits, survive and be competitive is a bigger problem today due to market liberalization (Prempeh, Sekyere & Amponsah, 2017).

The company's profitability is measured using the return on assets (ROA) ratio and return on equity (ROE) ratio. ROA shows the operating result before interest, depreciation and taxes above the carrying amount of the balance sheet (Murugesu, 2013). ROA is a metric that measures how

efficiently an entity converts funds used for purchasing assets into profits or net income during the financial year (Fareed et al., 2016). ROE quantifies the amount of money a company makes relative to the amount of money shareholders put into it. This indicates that ROE measures a corporation's ability to create a return on the capital invested by the company's owner (Roni, Djazuli & Djumahir, 2018). ROA is the best indicator because it combines a corporation's profitability with its total assets and is used by most researchers (Hoang, 2015).

1.1.3 Working Capital Management Policies and Profitability

WCM has a noticeable impact on both the profitability and liquidity of an organization. As a result, it may improve or decrease profits, which can either increase or decrease the value of the company's stock (Almomani, Almomani & Obeidat, 2021). The trade credit theory suggests that proper working capital management lead to a competitive edge for businesses. Therefore, they should maintain an optimal amount of WC to maximize profitability (Yazdinejad & Jokar, 2019). The tradeoff theory shows that the profitability of an organization shall be negatively affected as the company increasingly invests more in current assets and fewer current liabilities. This means that a low ROA is inevitable for any strategy that favors short-term investments, whereas excessive short-term investments would provide insufficient returns (Dash & Ravipati, 2009).

A study by Quy (2017) investigated WCM policies and their effects on firm performance and documented that aggressive WC policy had an adverse influence, but the conservative WC policy had a direct influence on performance. The impact of WC on firm performance was positively associated with profitability, according to an analysis by Sorin and Nucu (2021). Rey, Fernández and Rodeiro (2021) analysed whether WCM policies affects profitability and revealed that working capital components (inventory, payables and receivables management) significantly affected profitability. In their research, Sianipar and Prijadi (2019) found a correlation between WC and firm value and WC and profitability. Roni, Djazuli and Djumahir (2018) examined whether WCM affects profitability and found a positive interrelationship.

1.1.4 Cut Flower Companies in Kenya

According to estimates provided by the Kenya Flower Council (KFC), the flower business provides an annual contribution of US\$ 200 million to the economy of Kenya and employs close

to 2 million people directly and indirectly. According to data compiled by Bolo (2006) from the Horticultural Crops Development Authority (HCDA), Kenya's cut flower business accounts for up to 25% of all flower imports into the European Union (EU), surpassing both Colombia (17%) and Israel (2%). Bolo found that the cut flower sector in Kenya is the greatest single source of flower imports into the EU (16 Per cent). More than 70% of Kenya's annual flower exports to the European Union (EU) are roses, with subsequent shipments of carnations, hypericum, alstroemeria, and eryngium. Kenya sends sixty thousand metric tons of flowers to the EU. In addition to Holland, which receives the majority of Kenya's flower exports (about 65 percent), the United Kingdom, Germany, France, and Switzerland are also among Kenya's flower export destinations.

Bolo (2006) claims that up to 97% of Kenya's total flower exports are handled by a handful of mega-corporations controlled by either foreigners or ethnic Kenyans. This holds true whether the businesses in question are headquartered in Kenya or abroad. Flowers from farms with less than 100 blooming plants account for only 3% of all deliveries. Small-scale production has been declining because of increased regional rivalry and a lack of easy access to superior varieties. This disparity may be attributed to the high capital and expertise demanding nature of the flower industry, as well as the stringent regulatory market requirements, which have effectively shut out the bulk of the small scale farmers. The combination of these characteristics has made market entry challenging for new players. Bolo (2005, 2006) notes that large-scale farms sometimes have their own marketing arms that are established as sister corporations with European headquarters. They help the business sell and distribute its goods and learn about the market, which is subsequently integrated into the company's regular operations. However, it is challenging for smaller farms to compete in global markets.

1.2 Research Problem

A company's risk and profitability may be greatly affected by its approach to managing its working capital, hence this aspect of finance is crucial (Gomes, 2013). The efficiency of WCM not only increases profitability but also increases corporate market value (Quy, 2017). However, working capital is not always taken into account in financial decisions because it involves short-term investments and financing. In addition, WCM is not an easy task, as managers need to ensure

that the business is running efficiently and profitably (Murugesu, 2013). In addition, the majority of previous studies on corporate finance topics have concentrated on how long-term financing decisions impact a company's value. To date, WCM and its role in increasing profitability continues to stimulate debate among practitioners and researchers (Vijayakumaran, 2019).

One of the most important contributors to Kenya's economy is the agricultural sector (Chesang, 2017). However, most of the agricultural firms have continuously performed poorly. For example, out of seven publicly traded agricultural companies, three-reported poor performance in the 2014–2018 fiscal period and one company was delisted from the NSE as explained by Oruko and Tibbs (2020). Most companies in the agricultural segment have failed to live up to their wishes which has made repressed investment in the sector, exacerbating the downturn in the rural economy due to uncertain and low profit distributions (Kimencu, 2018). Muturi (2019) argue that the low volume of trade at the securities exchange is preventing agricultural investments from catching up because investors would rather deal with a market that is both liquid and easily accessible at stable pricing that are unaffected by exogenous elements such as weather.

Although Kasozi (2017) discovered a favorable relationship between WCM and the performance of South African listed corporations, Turaboglu and Topaloglu (2017) discovered a negative one for Turkish listed organizations. While Chebet (2015) found a substantial correlation between WCM and the output of Kenya's listed manufacturing enterprises, Awunya (2017) found no such connection between WC policy and the profitability of commercial organizations trading on the NSE. Some of the examined studies found positive correlations between variables, while others found negative correlations. Moreover, the research have been conducted in diverse contexts, such as industrial and commercial organizations, therefore the results cannot be extrapolated to agricultural businesses. This study thus seeks to determine, Does WCM policies affect profitability of agricultural firms quoted at the NSE?

1.3 Research Objective

The purpose of this study is to investigate the impact that different approaches for managing working capital have on the profitability of cut flower businesses in Kenya.

1.4 Value of the Study

This study adds on to the existing theoretical evidence on the trade credit theory, the tradeoff theory and the operating cycle theory. The study further adds on to the empirical evidence on the study concepts and introduce an opening for extra studies on the concept of WCM policies and profitability. Secondly, the study findings are of importance to policymaking institutions in Kenya to develop WCM policies, which also aid in WCM investing and financing policy. Managers at publicly traded agricultural companies may utilize the study's results and suggestions to improve the effectiveness of their work force compensation management policies and the companies' bottom lines. The administration and management of the firms also get additional information whether WCM polices enhances profitability.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The theoretical overview, an analysis of the determinants of profitability, and an analysis of empirical investigations are all included in this chapter. Additionally, the conceptual model and a brief synopsis of the relevant literature are presented in this chapter.

2.2 Theoretical Review

This study focused on the trade credit theory, the tradeoff theory and the operating cycle theory as the key theories guiding the study.

2.2.1 Trade Credit Theory

Long et al. (1993) conceptualized the trade credit theory, which indicates that good companies provide their customers with trade credit to reduce information asymmetry between seller and the buyer increase sales so that they can verify the products and services quality before paying. Additionally, the provision of trade credits helps to increase a company's revenue because it can serve as an effective price reduction (i.e., a cheap source of credit for customers because it strengthens long-term customer-supplier relations and encourages customers to buy goods) during low demand (Vijayakumaran, 2019). Motives for loan trading may include reducing the information asymmetry between the financial and non-financial markets, improving operational efficiency, reducing inefficiencies, opening up investment opportunities or increasing the competitiveness of its position (Dary & James, 2020).

The theory of trade credits states that short-term financing often takes the form of trade credits (also called merchant credits), where it is possible to defer the payment of trade payables, particularly in periods of depressed liquidity. It can be an effective trading tool in business dialogs and can be a good competitive edge tool or even an export-promoting tool. Thus, trade credits lead to higher trade payables due to extended terms of payment (Białek & Nehrebecka, 2016). However, trade credit theory is guided by industry practice, so the application of this strategy is limited and can be used selectively. Customers who have a low risk of default and can obtain

institutional financing on better terms may not be willing to accept business loans because their implicit costs are greater than institutional financing costs (Kumaraswamy & George, 2019).

The theory of trade credit suggests that WCM and especially trade credit management are of explicit significance to companies (Otto, 2018). Thus, trade credit is theoretically a vital criterion for choosing a supplier when it is difficult to distinguish products. The theory states that getting a trade credit is much cost-effective current investment compared to marketable securities. The other vital element of WCM is inventory management. Maintaining larger stocks allows companies to decrease acquisition costs, hedge against price instabilities, minimize production disruptions, and minimize losses to businesses due to inventory shortages. The theory also suggests that trade credits are a significant part of current liabilities; it is a significant part of working capital.

2.2.2 The Trade-Off theory

The Trade-Off theory, proposed by Shin and Soenen (1998), describes how a business determines its optimal cash supply by weighing the costs and advantages of keeping cash on hand. This theory indicates that liquidity costs increase with the level of working capital due to low returns. Conversely, the cost of illiquidity means that insufficient working capital is held, which causes the company to default and forces it to borrow at high interest rates in the short term. This affects the company's creditworthiness and may limit future access to finance and possible bankruptcy (Dash & Ravipati, 2009). The theory further argues that the main worry of companies is the smooth management of daily operations while increasing profitability for shareholders (Adam & Quansah, 2019).

This theory suggests that the trade-off between return and risk characterizes each of the WC decisions; hence, the key risk associated with WCM is liquidity risk. Liquidity risk is the unavailability of funds to pay unsettled obligations (Adam & Quansah, 2019). It can only happen on certain days. Companies that have a high level of liquidity in their working capital therefore have little risk of meeting their obligations while maintaining low profitability. Based on this theory, it can also be interpreted that in order to achieve high profits, a company must maintain

its working capital as efficiently as possible, even if it takes increased risk (Roni, Djazuli & Djumahir, 2018).

The trade-off hypothesis is one of the main theories explaining WCM, since it explains the tradeoff between risk and profitability associated with gross WC and liabilities. The theory indicates that cumulating profits at the expense of liquidity can cause grave complications for companies. According to the idea, there is a negative link between liquidity and profitability since liquid enterprises produce significant quantities of net WC, which may reduce profitability (Kaharuddin & Mazlan, 2018). This theory proposes that firms choose the sweet spot for their WC by weighing the costs and advantages of increasing WC investment (Adam & Quansah, 2019). The risk and profitability tradeoff is key in WCM as too little WC increases profit, but decreases liquidity, since short term assets are more costly than non-current assets.

2.2.3 The Operating Cycle Theory

The operating cycle (OC) hypothesis, proposed by Richards and Laughlin (1980), reconciles financial statement and income statement data. Both stocks and accounts receivable are considered part of the theory's framework as short-term assets. The average collecting period and the average ageing of the inventory are the two ratios that are used in the process of determining the length of an operational cycle. According to the hypothesis, when a company allows its customers to take use of credit facilities for a long period of time, not only will the company's profits likely increase, but it will also have challenges maintaining adequate levels of liquid assets (Khoa, Anh & Duyen, 2020). The OC is, in theory, the amount of time that elapses between the period when monies are spent on the procurement of operational resources and when revenues are received from sales. Inventories and receivables are included into WCM thanks to this principle (Dash & Ravipati, 2009).

The operating cycle denotes an entity's efficiency in managing working capital. It integrates inventories and receivables in working capital. Traditionally, the cycle begins from raw materials receipt to the collection of claims against debtors from sale of stocks (Aminu & Zainudin, 2015). Based on the OC theory, the probability of a positive financial result is when companies add more credit terms. This theory permits researchers to think of companies as a going concern. However,

contrasting the cash conversion cycle, the OC excludes liabilities from the liquidity examination; therefore, the OC fails to explain the net trade cycle (Khoa, Anh & Duyen, 2020).

The operational cycle technique is more effective at managing liquidity than the conventional method, which used liquidity measures like the acid test and current ratios to assess a company's financial health. The traditional approach was replaced by the operating cycle approach because of its higher level of accuracy. According to Biaek and Nehrebecka (2016), a prolonged operational cash cycle indicates that it takes a company longer to collect payment for items supplied on credit. Accounts receivable balance (a component of WCM) and a company's bottom line are predicted to react differently to variations in credit and collection practices, according to this theory (Otto, 2018). According to the theory, businesses should implement WCM components like inventory and receivables indicators because these metrics are beneficial to WCM and improve a company's overall financial performance. Additionally, the theory suggests that businesses should embrace WCM components.

2.3 Determinants of Profitability

2.3.1 Firm Size

Some believe that a company's size is a crucial component in determining its profitability. When a company is big in the market, it has a bargaining ability with suppliers and as well as lenders who will be willing to advance finances to the firm. In addition, a big company has strong sales channel hence it is able to reach end customers very quickly (Sianipar & Prijadi, 2019). Large companies benefit from economies of scale, are less risky and can therefore achieve lower production and capital costs. However, small enterprises are more able to respond to market shifts. The preferred mix of capital structure may have an impact on a company's bottom line depending on its size. Given the relative ease with which big firms may access capital market funding, they are also less reliant on cash generated from inside the company (Rezina, Ashraf & Khan, 2020).

2.3.2 Leverage

Long-term capital structure is commonly discussed in terms of a company's leverage, which is defined as its capacity to borrow money for day-to-day operations (Yussuf, 2019). The term leverage refers to the use of an entire company's debt at either its market or book value. Leverage

affects a company's bottom line since borrowing more money means spending more money on interest. This is accomplished via the financing of stock and debt within the capital structure (Rezina, Ashraf & Khan, 2020). Debt is a method via which managers may be disciplined by the financial markets. Consequently, the investment firm's overhead costs may be lowered, leading to more profits and a greater market value. Therefore, as long as there is debt in the economy, managers may produce additional assets for their owners. The leverage ratio measures the amount of debt as a percentage of total assets (Adam & Quansah, 2019).

2.3.3 Firm Age

The age of the company specifies how long the company has been in industry. Over time, the company has gained experience in the prudent management of business operations. The company's financial success is therefore actively influenced by its age (Sianipar & Prijadi, 2019). The older the company, the easy it is to get resources over time. A company's age is linked to better reputation, more experience, better access to business networks, more information and funding institutions that help a company overcome the limited access to funds and work more efficiently (Yussuf, 2019). It is widely believed that older companies could get easy funding based on their years of experience, business reputation and compatibility. However, due to bureaucracy, older companies sometimes lack the flexibility to make quick decisions and innovate (Sahabuddin & Synthia, 2020).

2.4 Empirical Review

Women's capital investment and finance restrictions were studied by Almomani, Almomani, and Obeidat (2021). All of the mentioned manufacturers were based in Jordan. Information on 42 companies' working hours was collected between 2010 and 2018. In addition to the regression model, descriptive statistical approaches were also utilized to analyze the data. Profitability in manufacturing companies was shown to be significantly influenced by the frequency with which receivables, inventory, working capital, and current assets were turned over.

The impact of WCM procedures on insurance businesses' financial performance was studied by Wambia and Jagongo (2020) in Kenya. Primary data were gathered through questionnaires filled out by 141 participants in this descriptive survey. Analysis of data was undertaken through

regression and descriptive statistical tools. The research showed that many types of working capital plans are used by insurance companies in Kenya, including the more extreme ones. Insurer profits were observed to increase significantly and favorably in response to WCM policies.

Adam and Quansahas (2019) in Ghana studied the link between WCM policies and firms value. The study was undertaken among listed manufacturing firms and secondary data was collected from 2000 to 2013 (13 years). This study employed non-experimental survey techniques and dynamic regression models to examine the data. In terms of investment strategies, both risk-averse and risk-taking approaches were shown to have an impact on returns (measured in terms of Economic Value Added) (Tobin Q and the MBV). Conservative financing approach was shown to increase company value, according to the research (MBV and EVA).

Vijayakumaran (2019) examined whether WCM policies affect performance of large listed Chinese firms. The study used the net trade cycle (NTC), as a proxy for WC policies while the firms' performance was proxied by the Tobin Q. Analysis of data was undertaken through the panel regression approach. According to the results of the research, the NTC hampered the efficiency of the businesses studied. Positive and sizable effects of inventory and receivables management on the bottom lines of the companies studied were also found.

The impact of WCM procedures on company success was studied by Kiptoo, Kariuki, and Kimani (2017). Multiple tea factories in Kenya contributed to the study. A descriptive study was conducted, with questionnaires used to collect information from 48 different companies. Statistical methods such as correlation and regression were used to examine the data. The results imply that the firms' bottom lines were affected adversely due to ineffective and excessive inventory management. Correct receivables management, the research found, has a large and beneficial impact on financial outcomes for businesses.

Studying how WCM affects SME productivity, Kosgey and Njiru (2016). (SMEs). Nakuru County's SMEs were the study's subjects. To accomplish our goal of conducting a descriptive examination of the operations of the small and medium-sized enterprises included in our study, we sent questionnaires to them. A regression model and descriptive statistics were used during

analysis. There was a significant correlation between a company's cash flow, inventory management, and revenue growth, as shown by the data. According to the findings of the research, WCM has a considerable and favorable impact on the profitability of SMEs.

Hoang (2015) studied whether WCM affects firms' profitability. The study was undertaken among listed manufacturing firms and data was collected from 98 entities between 2009 and 2014 (5 years). In order to analyze the data, we used the SPSS program and the regression model. According to the results, many operational processes have a major impact on a company's return on assets. It was also discovered through the studies that firm performance was significantly affected by factors such as company size, liquidity, growth, and leverage.

Chemis (2015) looked at the link between WCM and financial success. Subjects for the study came from several Kenyan sugar factories. Researchers utilized a data collection sheet to gather information from eight different businesses between 2008 and 2013. The data went through both a correlation analysis and a regression model. It was discovered that the cash conversion cycle benefited the analyzed companies' bottom lines. The research found that the management of WC aspects including inventories, receivables, and payables had a direct impact on a business's bottom line.

Nyamweno and Olweny (2014) examined whether WCM affects firms performance. The study collected secondary from 27 firms quoted at the NSE from 2003 to 2012. The data was analyzed using a dynamic panel data technique. The research indicated that the company's cash conversion cycle and receivables management were stumbling blocks to its development. Inventory management, like accounts receivable, was shown to have a favorable and statistically significant impact on financial outcomes for businesses. Researchers also found that bigger businesses had a higher productivity rate when inflation was factored in.

Iqbal et al. (2014) studied whether WCM affects Pakistan textile firms' profitability. The authors collected data from a sample of nine listed Pakistan textile firms between 2006 and 2012 through a data collection sheet. In order to analyze the data, a regression model was used. According to the results, WCM negatively correlated with company profitability. Specifically, the study

documented that WC components (inventory, payable and inventory management) significantly and positively affected the sampled firms' profitability.

2.5 Conceptual Framework

This research uses WCM policies (working capital investment and finance policy) as independent variables and profitability as the dependent variable. Figure 2.1 shows that firm size, leverage, and age will be control variables.

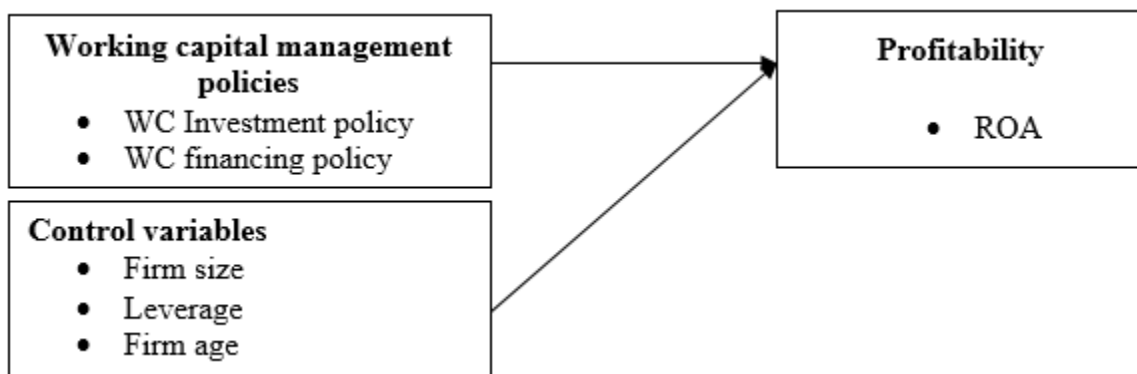


Figure 2.1: Conceptual Framework

2.6 Summary of Literature Review

Under this chapter, a number of studies were reviewed to establish the methodologies used, the study's context and the gaps emanating from those studies. Studies by Almomani, Almomani and Obeidat (2021) focused on industrial firms, Adam and Quansah (2019) in Ghana focused on manufacturing firms while Vijayakumaran (2019) focused on large Chinese listed firms. Further, Hoang (2015) and Iqbal et al. (2014) found a negative relationship while Vijayakumaran (2019) found a positive link. In Kenya, Wambia and Jagongo (2020) focused on insurance firms and used questionnaires to collect data, Kiptoo, Kariuki and Kimani (2017) focused on tea processing firms and used primary data while Kosgey and Njiru (2016) using questionnaires focused on SMEs. From the reviewed studies it evident that various gaps exist on the relationship between WCM and profitability. The studies documented conflicting results that can be attributed to different methodologies, concept as well as the contexts in which they were undertaken.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the study design, the study's targeted population, the techniques and methods of collecting data as well as the methods of analyzing data.

3.2 Research Design

Descriptive research methods were used for this investigation. To profile a group of individuals, a set of qualities, or an event, for example, requires gathering information and tabulating the study variables or their interaction. A descriptive study was conducted in order to investigate the variables without influencing them in any way and to present the many characteristics that constitute competence. In addition, descriptive research, regardless of whether it is qualitative, quantitative, or a mix of the two, makes accessible all of the information there is to know about the situation or event that is being researched. This design is based on observation as a method of data gathering, and it aims to analyze the scenario in order to determine what a standard is, which is defined as anything that can be replicated while maintaining the same conditions. It all comes down to who, what, where, when, and how much (Cooper & Schindler, 2007).

3.3 Population of the Study

The participants in this study included all 91 certified members of the Kenya flower council as of the 31st of December 2021. As a result, the research project conducted a survey of all 91 cut flower businesses. A thorough enumeration of all of the units that make up the population under study is an essential part of the census methodology. Cooper and Schindler (2007) suggest that a census is probable for a small population and necessary when the elements are very different. Since the population was small and the cut flower firms are certainly accessible, it was appropriate to use a census.

3.4 Data Collection

The 91 companies that are part of the Kenya Flower Council provided the only secondary data utilized in this research via their yearly financial statements. Companies' websites and the Kenya Flower Council database were mined for the remarks. Current assets, current liabilities, total

assets, net profits, total debt, and years in business were among the significant data gathered. From 2017 to 2021, a data collecting form was to be used to compile the information in question.

3.5 Data Analysis

After entering the obtained data into Excel, they were examined using descriptive statistics such as the mean and the standard deviation, as well as inferential statistics, which involved developing a regression model using the SPSS program.

3.5.1 Diagnostic Tests

Table 3.1 details the various diagnostic procedures that were carried out.

Table 3.1: Diagnostic Tests

Assumption	Description	Test	Interpretation	Treatment
Normality	To verify normal distribution, the test is conducted	Shapiro–Wilk test	If p values are above 0.05, the variables are normally distributed	application of square roots or logs to non-normality
Linearity Test	There is linearity when there is a linear link between the variables.	ANOVA test	A linear relationship exists where the alpha values are < 0.05	Use of the reciprocal method
Multicollinearity	The phenomenon known as multicollinearity occurs when there is a connection between many variables, which then leads to the standard errors distorting the regression analysis.	VIF Test	Multicollinearity exist where the VIF > 10	Eliminate highly correlated variables.
Heteroscedasticity	to determine whether the model's or the errors' variance is different for each observation	Breusch–Pagan test	Heteroscedasticity exist where the p-value p<0.05)	Use Natural log of variables

Autocorrelation	To determine the value of a single variable by considering other variables that are connected to it.	Breusch-Godfrey test.	If p-values are lower than 0.05, autocorrelation is present.	Hildreth-Lu Procedure
Stationarity test	In order to evaluate whether or not a time series variable has a unit root and whether or not it is stationary	ADF test	If p values are below 0.05, unit roots exist.	Use Natural log of variables
Hausman specification test	When deciding on a statistical model, it's important to differentiate between fixed-effects and random-effects approaches.	Hausman test	Use fixed effects model if p value is less than 0.05 and random effects if otherwise	Use natural log of variables

3.5.2 Analytical Model

Regression was used to test the interrelationships between WCM and profitability. This regression model was as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon$$

Where;

Y = Profitability (ROA);

X_1 – ACP: Average Collection Period;

X_2 - ICP: Inventory Conversion Period;

X_3 – APP: Average Payables Period;

X_4 – CCC: Cash Conversion Cycle;

β_0 – Intercept; $\beta_1 - \beta_5$ – beta coefficients;

ε – Error term

3.5.3 Tests of Significance

The relevance of the overall model as well as the variable was determined via the use of parametric tests. To determine whether the model is useful, the study used the F-test and the analysis of

variance (ANOVA), but to determine if any given variable is statistically significant, the study used the t-test.

CHAPTER FOUR

DATA ANALYSIS

4.1 Introduction

This section delves into the study's findings and gives an interpretation of the data obtained. The study set out to investigate whether or not cut flower companies in Kenya are more or less profitable as a result of WCM regulations. The descriptive statistics of the data are shown in the next section (4.2). Analysis of the Durbin-Watson test, the Pearson correlation, and the regression are presented and discussed in the following sections.

4.2 Descriptive Statistics

The table below summarizes the study's findings by displaying the number of observations as well as the mean, maximum, and lowest values for each variable.

Table 4.1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	425	-.1909	.4119	.133075	.1304529
ACP	425	.1274	101.6432	44.525770	28.4470043
ICP	425	27.1351	238.5592	112.924996	53.3136791
APP	425	4.4610	217.1241	63.219637	59.7787771
CCC	425	-100.3980	226.2118	93.825703	74.4660680
Valid N (listwise)	425				

The return on assets (ROA) has a range that may go as low as -19.09% and as high as 41.2% on average. The average is 13.31%. The return on assets has a S.D of 13.05%, which indicates that there is a significant amount of fluctuation within the industry. With a S.D of 28 days, the typical time it takes for these businesses to collect on receivables is 45 days. This number may go as high as 102 days. As a result, it seems that the typical credit duration offered by these companies to their customers is 45 days. A typical ICP is 112 days, but may be as low as 27 days or as high as 239 days. The standard deviation for this period is 53 days. The amount of time that it takes companies to pay their trade payables, also known as APP, ranges from as little as four days to as much as 217 days, with the average being 63 days and the standard deviation being 60 days. In addition to this, it takes these companies an average of 93 days to turn the resource inputs they use

into cash. The CCC had a standard deviation of 74 days, which indicates that there is a large amount of volatility within the sector.

4.3 Durbin-Watson test

Table 4.2: Durbin-Watson test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.611 ^a	.373	.305	.1087532	1.720

a. Predictors: (Constant), CCC, ACP, ICP, APP

b. Dependent Variable: ROA

Since the Durbin-Watson statistic, $d = 1.720$, falls within the range of values that are between 1.5 and 2.5, this indicates that the values of the estimated residuals are not dependent, and there is therefore no autocorrelation problem in the model.

4.4 Correlation Analysis

The use of pearson correlation analysis allowed us to ascertain the presence or absence of a linear connection between two variables, as well as the strength and direction of any such associations. The correlation coefficients (r-squared) and probability values (p-values) between the WCM variables and ROA are shown in Table 4.4. The results showed that ROA and ACP were negatively correlated ($r = -0.509$, $p 0.01$). As a result, it seems that a decrease in ROA might be predicted if ACP levels rise, and vice versa. Timely collection of receivables has a substantial beneficial influence on cash flows and return on assets, whereas late payments and bad debts have a negative impact on profitability and result in poor return on assets. This analysis found that the cut flower sector might see a considerable boost in return on assets if it were able to reduce its ACP. This research agrees with that of Mathuva (2009), who found that ACP had a negative correlation with profits for 30 companies trading on the NSE between 1993 and 2008. This results is compatible with the findings of Mathuva (2009). Additionally, Gill et al. (2010) place an emphasis on reducing a company's ACP as a means to increase profitability.

Table 4.3: Pearson Correlation Coefficients

		ROA	ACP	ICP	APP	CCC
ROA	Pearson Correlation	1				
	Sig. (2-tailed)					
ACP	Pearson Correlation	-.509**	1			
	Sig. (2-tailed)	.001				
ICP	Pearson Correlation	-.077	-.041	1		
	Sig. (2-tailed)	.629	.795			
APP	Pearson Correlation	.075	.259	.066	1	
	Sig. (2-tailed)	.638	.097	.676		
CCC	Pearson Correlation	-.308*	.153	.638**	-.631**	1
	Sig. (2-tailed)	.047	.334	.000	.000	

The CCC negatively correlates with ROA, with a correlation coefficient of -0.308 and a p value of -0.047 at the 95% confidence level indicating that improving financial performance is possible by shortening the CCC. A low CCC suggests that a company's short-term assets are only temporarily committed to the business cycle, which is good since it frees up funds to be spent in growing the business, which in turn boosts sales and return on assets. Falope and Ajilore (2009) likewise found a substantial inverse correlation between CCC and profitability. Eljelly (2004) came to the conclusion that increased profitability is connected with a shorter CCC after seeing a substantial negative association between profitability and the CCC of 929 Saudi companies. A negative CCC is quite desired, and the finding that this research produced a negative CCC is itself a noteworthy result. Due to the characteristics of their goods, customers, and suppliers, however, not all businesses are able to attain a negative CCC.

With a coefficient of -0.077 and a p value of 0.629, it is possible to demonstrate a link between ROA and ICP; however, this correlation is too weak to be deemed statistically significant. In order

to reduce the possibility of obsolescence and the cost of warehousing, a shorter Less ICP is preferable. This is because it improves the probability that the inventory will be converted into sales more rapidly. More so, ROA is positively related to APP, however this is not statistically significant ($r=0.075$, $p=0.638$). An increase in APP is associated with an increase in profitability, which may be explained as a result of businesses delaying the payment of trade payables in order to use the resulting cash flow to buy more inventory to resell at a profit. Gill et al. (2010) looked at NYSE-listed companies and found no link between APP and financial success.

4.5 Regression Analysis

This investigation employed regression to see whether differences in ROA could be attributed to ACP, ICP, APP, or CCC.

Table 4.3a: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.611 ^a	.373	.305	.1087532	1.720

a. Predictors: (Constant), CCC, ACP, ICP, APP

b. Dependent Variable: ROA%

The model summary as well as the overall fit statistics are shown above in table 4.5a. The model has an R-square value of 0.372, which indicates that the ACP, ICP, APP, and CCC are collectively responsible for determining 37.2% of the variation in the enterprises' levels of profitability. In other words, out of all of the factors that might cause ROA to fluctuate, the WCM variables can account for 37.2% of those factors.

Table 4.3b: Analysis of variance

Model	Sum of Squares	df	Mean Square	F	Sig.	
1	Regression	.260	4	.065	5.498	.001 ^b
	Residual	.438	420	.012		
	Total	.698	424			

a. Dependent Variable: ROA

b. Predictors: (Constant), CCC, ACP, ICP, APP

The regression equation's fit was assessed using analysis of variance. In Table 4.5b, ROA variables and WCM variables show a positive multiple linear connection. The impact of WCM on ROI was found to be substantial. With a computed F-statistic of 5.498 and a P-value of 0.001, the significance level is well over the 0.05 threshold. Inferring from these results, we find that ACP, ICP, APP, and CCC are all positively connected with ROA among the WCM factors.

Table 4.3c: The Coefficients of the Model

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.25514	.05305		4.809	.000
1 ACP	.01298	.0723	2.831	1.797	.081
ICP	.01482	.0698	6.055	2.123	.041
APP	.01481	.0709	-6.785	-2.090	.044
CCC	.01532	.0709	-8.744	-2.160	.037

a. Dependent Variable: ROA

Table 4.5c displays the results of the regression coefficients for ROA vs ACP, ICP, APP, and CCC, all of which are variables of WCM. Therefore, the link between ROA variables and WCM variables may be summed up using the linear equation that is shown below.

$$\text{ROA} = 0.2551 + 0.01298\text{ACP} + 0.01482\text{ICP} - 0.01481\text{APP} - 0.01532\text{CCC} + \varepsilon$$

Due to the fact that ROA was expressed as a percentage, the equation that was just presented may be recast as follows for more clear comprehension.

$$\text{ROA}(\%) = 25.51 + 1.298\text{ACP} + 1.482\text{ICP} - 1.481\text{APP} - 1.532\text{CCC} + \varepsilon$$

Based on the model constant of 0.2551, we know that if we forced all of the independent variables to be zero, the ROA would be 25.51%. The model's coefficients characterize the change in ROA

caused by a single unit change in one of the independent variables while all other variables are maintained constant. A positive value of 1.298 characterizes the average collection period (also known as ACP). This indicates that there will be a 1.298% rise in ROA for every one unit increase in ACP, provided that all other independent variables remain same. Since the t-statistic of the coefficient is not significant due to the fact that its p value is 0.081, there was not found to be a linear relationship of ROA on ACP alone that was statistically significant. With an ICP regression value of 1.482, we may expect a 1.482% boost to ROA for every unit rise in ICP, everything else being equal. The t-statistic of the coefficient indicating a linear relationship between ROA and ICP alone is statistically significant at the 0.041 level of significance.

With an ICP regression coefficient of -1.481%, we may deduce that if all other independent variables remained constant, ROA would drop by 1.482% for every 1% rise in ICP. Since the coefficient has a statistically significant t-statistic ($p = 0.044$), we may deduce that ROA depends linearly on APP alone. For example, if the other independent variables in the model remain same, the -1.5321 regression coefficient suggests that a one-unit increase in the cash conversion cycle (CCC) would lead to a 1.532% fall in ROA. The linear association between ROA and ICP alone is statistically significant, as shown by the t-statistic of the coefficient being significant at the 0.037 level of significance.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

Summary findings, recommendations, and limitations drawn from the study are presented in this last chapter. It also offers recommendations on where more research is needed. The study set out to assess how WCM regulations affect the bottom lines of Kenya's cut flower industry participants.

5.2. Summary of Findings

This study aimed to examine the effects of WCM policy on the productivity and profitability of Kenya's cut flower businesses. The duration of time that was examined was a whole five years. According to the findings, the WCM has a substantial influence on the companies who sell cut flowers in terms of how well they do financially. The longer it takes to process transactions and convert them into cash, the more detrimental they are to a business' bottom line when the CCC and rate of receivables collection are sluggish. A company's credit management strategy can aid in the maximization of forecasted profits by facilitating the prompt collection of receivables.

An improved liquidity situation, as indicated by a lower CCC, allows businesses to take advantage of cash purchase discounts and improves the company's credit rating, making it simpler to acquire favourable financing. This provides a means via which businesses may maximize their earnings. The Keynesian theory of liquidity preference advocates for liquidity for a variety of purposes, including transactions, speculation, and risk management. A CCC that is negative is something that should be sought for, and the fact that this investigation identified a negative CCC is a fascinating conclusion. Certain firms displayed a negative CCC over the course of the time under consideration, which was correlated with a comparatively greater ROA. These businesses paid their vendors long after they had collected money from product sales. However, because to differences in their goods, customers, and suppliers, not every business can achieve a negative CCC.

Since inventory conversion time was inversely related to ROA, it follows that reducing the amount of time a company must wait to sell its inventory can boost ROA. A poor return on investment (ROI) is the result of having high inventory levels since this means that money that might be

reinvested are instead being held in inventory, in addition to the fees for storage, as well as the danger of obsolescence. The fact that the CCC rises when the ICP is high indicates that there is a potential danger to the inventory's liquidity. Managers may employ just-in-time (JIT) to keep inventory levels at a minimum and save money on storage expenses. The findings also revealed a beneficial influence of APP on ROA, despite the fact that this impact was not statistically significant. This finding suggests that managers are able to boost ROA by delaying payment of invoices without negatively impacting the company's credit rating. There was a substantial negative link between profitability and ACP of listed manufacturing enterprises in Ghana, as discovered by Akoto et al. (2013), however these results contradicted their findings.

5.3 Conclusions

According to the results of this study, the four WCM variables (ACP, ICP, APP, and CCC) have a substantial correlation with manufacturing firms' financial outcomes. ROA, an indicator of financial performance, was negatively correlated with WCM on both the ACP and CCC measures (ROA). There was no statistically significant link between APP and ROA either positively or negatively. However, both of these variables were correlated with ROA in some way. This research indicates that manufacturing companies will have a considerable increase in their ROA if they succeed in lowering their ACP, CCC, and ICP.

It was concluded that there was no statistically significant linear dependency of ROA on ACP since the t-statistic for the ACP coefficient was not statistically significant when all other model variables were held constant. With all other factors held constant, the statistical significance of the t-statistic for the ICP coefficient indicates that ROA does depend linearly on ICP. With the other independent variables maintained constant, we can conclude that ROA does depend linearly on APP since the APP coefficient has a significant t-statistic. Significant t-statistics for the CCC coefficient suggest that ROA does depend linearly on CCC alone.

To maximize profits and reduce losses, businesses need to make WCM choices that minimize costs and risks while maximizing the efficiency of their cash flow across the business cycle. The results of the research might indicate that WCM is consistent with those who desire to maximize their

gains. If management is careful to track how working capital affects profitability, the company's value to shareholders might rise.

5.4. Recommendations

On the basis of the data, it is possible to make the suggestion that management should make every effort to cut the ACP, CCC, and ICP. The ACP may be improved by implementing a system for collecting trade receivables, which will assist the firm in collecting receivables as promptly as possible while minimizing the risk of losing sales. A credit policy and analysis system, as well as a credit control system, will be developed by the company in order to facilitate the operation of its trade receivables collection system. JIT, or just in time, is a management method for ensuring that stock levels are always appropriate while minimizing the cost of holding inventory. Management of both customers and suppliers should aim for a negative CCC, even though it's impossible for certain enterprises to do so owing to the nature of their goods. Managers have the power to boost profitability by delaying payment of trade payables; however, this should be done in a manner that does not negatively impact the company's credit rating.

5.5. Limitations of the Study

The study's use of a non-random convenience sample is a significant caveat. Eighty-five businesses were willing to be researched despite the fact that all 91 authorized members of the Kenya floral council were supposed to be included.

5.6. Suggestions for further Research

The negative CCC is one of the most surprising discoveries in this study, which concluded that a research void existed. Negative CCC firms in this industry were shown to have outperformed their rivals during the study period. Therefore, there is room to further this investigation into the optimal CCC, the results of a negative CCC, and the risks associated with a negative CCC.

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