The relationship between working capital management and profitability of listed companies in the Nairobi Stock Exchange

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Abstract:

A well designed and implemented working capital management is expected to contribute positively to the creation of shareholders‟ wealth. The purpose of this study was to determine the empirical relationship between working capital management and firm‟s profitability. The study used secondary data obtained from annual reports and financial statements of companies listed on the Nairobi Stock Exchange (NSE). A sample of 24 companies listed on the (NSE) for a period of six (6) years from 2001 – 2006, were studied to determine the effect of different variables of working capital management including average collection period, inventory turnover in days, average payment period and cash conversion cycle on the gross operating profitability. Current ratio, size of the firm (measured in terms of natural logarithm of sales), fixed financial assets to total assets ratio and debt ratio were used as control variables. Pearson‟s correlation and regression analysis (pooled least squares) were used for analysis. The results show that there is a statistical significant negative relationship between variables of working capital management and the profitability of firms except for the average payment period which showed a positive relationship. This means that managers can create profits for their companies by handling correctly the cash conversion cycle and keeping each different component of working capital management (accounts receivables, accounts payables and inventory) at an optimal level.