

Working Capital Management and Financial Performance of Secondhand Car Trading Companies in

Kampala District, Uganda

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Abstract

The study examined the relationship between working capital management and financial performance. The study applied a cross-sectional research design and a quantitative research approach. The study selected a sample of 242 secondhand car trading companies from 628 by simple random sampling. A structured questionnaire was used to obtain data from either an accountant or business owner. Validity of the instrument was by expert judgment while reliability was by Cronbach alpha coefficient. This study further applied confirmatory factor analysis to identify the measures which were perceived as good measures for the constructs. The study obtained Cronbach's alpha coefficient to check for the internal consistency of the scales. Out of 242 second hand car trading companies, the study obtained responses from 192, giving a response rate of 79.3%. The attained response rate is above the minimum acceptable coverage of 70% for considering the results fit for generalization. Data analysis was carried out using SPSS (v20) to extract frequency tables, descriptive and inferential statistics for presentation and interpretation. The study found a positive relationship between working capital management and financial performance. Regressed results obtained that jointly working capital management and risk management are significant predictors of financial performance. Risk management was found as the better predictor. The study concluded that risk management and working capital management are among the key factors that affect financial performance among secondhand car trading companies. The study also observed secondhand car trading companies would financially perform much better if concentration is directed towards risk management. Accordingly, the study recommends; risk assessment, risk mitigation, risk monitoring and control.

Keywords: Working Capital Management, Financial Performance, Risk Assessment, Secondhand Car, Trading Companies.

Introduction

Organizations today have developed a variety of processes and techniques designed to contribute to financial performance (Haresh, 2020). In support, Nireesh (2020) is of the view that the ultimate objective of any organization is to sustain its existence by improving its financial health. Almatrooshi, Singh and Farouk (2016) suggest that the potential of the firm to succeed, implement

strategies as planned and remain competitive relies on their potential to enhance financial performance. Accordingly, there is great interest to understand the the factors enhancing financial performance among companies. Some empirical studies indicate that financial performance depends on working capital management and risk management (Almazari, 2019;

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Gates, Nicolas & Walker, 2018; Saleem & Abideen, 2017; Sumathi, 2016).

According to Doan et al., (2016), it is no longer sufficient to only manage hard costs, but timing of production, speed of production and payments will also be crucial to manage. What Casey is referring to could be described as focusing improvements on speeding up cash flows and utilize working capital management more efficiently. Consistently, Dong and Su (2010), proper working capital management enhances the firm's ability to fund the difference between short-term assets and short-term liabilities. It is argued that the essential part in management of working capital management lies in maintaining adequate liquidity in day-to-day operations to ensure smooth functioning of the business, which in turn results into better performance outcomes. Furthermore, Sumathi (2016) concludes that there is significant statistical relationship between working capital management and financial performance. The study obtained that companies with fast Cash Conversion Cycle (CCC) are able to acquire internal resources for reinvestment and enhancing profitability by stimulating multiplier effect, compared to firms with a relaxed collection period. Similarly, Wang, Yiu and Mak (2013) identified that inventory management enable companies to effectively maximize the total expected profit or to

minimize the expected total cost over a planned horizon.

Al-Shubiri and Aburumman (2013) there is a distinct relationship between profitability and CCC but put further emphasis on avoiding sub optimization and improved CCC for one firm on the behalf of other value chain members. Moreover, a study by Orobia et al., (2016) suggests that working capital management is the most crucial factor for maintaining liquidity, survival, solvency and profitability of business, aspect that are vital in the financial performance of an institution. Earlier study by Anser and Malik (2013) conducted a comparative analysis obtaining that companies with effective working capital management reveal more profits and are more stable compared to firms with weak working capital management. They further believe that squeezing suppliers and buyers on better payment terms for the focal company only 5 yields short term returns. In a long-term profit perspective this moves focus from Days Sales Outstanding (DSO) and Days Purchases Outstanding (DPO) to Days Inventory Outstanding (DIO). Efficient WCM is necessary for achieving both liquidity and profitability of a company. A poor and inefficient WCM leads to tie up of funds in idle assets reduces the liquidity and profitability of a company (Anser & Malik, 2013).

Statement of the Problem

Effective management of working capital management and risk is increasingly becoming a central component for financial performance the world over (Altaf & Shah, 2021). Indeed, in Uganda, auto companies are attaching utmost significance to working capital management and risk management. Such companies are offering cash discounts and reduced repayment period as well as contracting insurance companies to manage working capital management and risks (Automobile Association of Uganda (AAU, 2022). In spite of all the above, the financial performance for

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secondhand car trading companies continue to decline. This is manifested in the decline in the revenue collected by URA between 2019 and 2021 by 30% (URA Annual Report, 2022). Furthermore, Jambo Auto Mart Annual Report (2021) indicates a decline in profit from UGX. 3.5 billion to UGX. 2.09 billion between 2020 and 2021. Ramzan Motor Ltd Annual Report (2021) also highlight ROE decline by 2.5% in 2021. The declining financial performance of the companies is affecting the overall operations of the companies (Automobile Association of Uganda, 2022). It is likely that inadequate financial performance may be attributed to decline in working capital management and inadequate risk management. However, limited empirical information is available to explain this trend hence the motivation to address this gap.

Objective of the Study

The study examined the relationship between working capital management, risk management and financial performance in secondhand car trading companies in Kampala.

Research Question

What is the relationship between working capital management and financial performance in secondhand car trading companies?

Methodology

The study applied a cross-sectional research design. This research design enhances large sample coverage (Field, 2009). In addition, the study also adopted a quantitative research approach to simplify the analysis and interpretation of data. The approach was appropriate considering the relational nature of the set objectives. The study population comprised of 628 secondhand car trading companies operating within Kampala District (Automobile Association of Uganda, 2021).

Results

Descriptive Statistics

The study generated means and standard deviation to summarize the observed data. The justification for reporting the mean is to summarize data and standard deviation to establish whether the statistical means are a good fit of the observed data (Field, 2009). The results are presented in Table 1.

Table 1: Descriptive Statistics

Variable/Construct	Mean	Std. Deviation	n
<i>Working capital management</i>	3.83	0.483	192
Receivables Management	3.8503	0.84462	192
Payables Management	3.8451	0.84018	192
Cash Management	3.8026	0.58555	192
Inventory Management	3.7413	0.91378	192
<i>Risk Management</i>	3.76	0.467	192

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Risk Assessment	3.6875	0.76104	192
Risk Mitigation	3.7847	0.87892	192
Risk Monitoring and Control	3.8359	0.99891	192
<i>Financial Performance</i>	<i>3.78</i>	<i>0.491</i>	<i>192</i>

Source: Primary Data

Table 1 reveals that all the mean values for working capital management, risk management and financial performance are 3.83, 3.76 and 3.78 respectively with corresponding standard deviations of .483, .467 and .491. The mean values portray that most responses were in agreement with the different statements provided. The low SD in relation to the variables of working capital management, risk management and financial performance signify a very low variability of the minority responses which disagreed with the statements presented. This further implies low bias in the responses obtained. Henceforth, the calculated mean values for each of the variables is a good replica of reality (Field, 2009; Saunders, Lewis & Thornhill, 2007).

Factor Analysis

This study obtained a factor structure for variables of the independent and mediating variable to establish the good measures of the constructs studied under each construct. According to Field (2009) factor analysis is a technique which helps in identifying groups or clusters of variables and has the usefulness of reducing a data set to a more manageable size while ensuring that original information is maintained as much as possible. In addition, Kagaari, Munene and Ntayi (2010) indicate that factor analysis is “a powerful and indispensable method of construct validation” that “is at the heart of measurement of constructs” and this explains why this study used these statistics. This study used a rotation method of Varimax with Kaiser Normalization and the Principal Component Analysis. This study suppressed items with a correlation of less than 0.5 from the rotation table.

Table 2: Factor loading for working capital management

	Receivables Management	Payables Management	Inventory Management
We offer discounts to customers who fulfil their obligations on time	.786		
Customers due dates are closely monitored	.725		
We have maximum credit that we can render to our customers	.716		
We have adequate procedures to follow-up and collect from our customers	.638		
We make plans on how to clear debts		.810	

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We write down details of debt, whenever it occurs	.742		
We pay suppliers on set due dates	.605		
We are able to cover unexpected costs	.555		
We maintain and monitor our stock levels			.823
We are always review inventory levels of cars			.722
We have a policy inventory level that must be kept at any one given time			.643
Total	2.171	1.957	1.722
% of Variance	19.740	17.787	15.653
Cumulative %	19.740	37.527	53.179

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.

Source: Primary Data

Results from Table 2 indicate that receivables management is responsible for 19.740%, payables management 17.787% and inventory management, 15.653% of the aggregated variance of 53.179% in financial performance resulting from inventory management. From the Eigen values of receivables management (2.171), payables management (1.957) and inventory management (1.722), the statistics signify that working capital management is best explained using receivables management.

Inferential Statistics

Correlation analysis was used to determine the relationship between the indicated variables. A correlation analysis is a statistical function used for testing a relationship between two or more variables. That said, the coefficient of correlation (r) is used to determine whether the relationship is perfect, strong, moderate or weak and the value ranges between -1 and 1. In this research, *positive and negative correlation* is used to indicate the nature of the relationship alongside the strength of the relationship. The study further ascertains whether the relationship between the variables is significant or not based on the ascertained p-values (2-tailed). The results obtained are summarized in Table 3.

Table 3: Correlation Analysis

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Working capital management (1)	1									
Receivables Management	.667**	1								
(2)										
Payables Management (3)	.646**	.207**	1							
Cash Management (4)	.334**	.311**	.165*	1						
Inventory Management (5)	.459**	.192**	.077	.233**	1					
Risk Management (6)	.305**	.283**	.114	.300**	.366**	1				
Risk Assessment (7)	.221**	.208**	.071	.274**	.241**	.614**	1			
Risk Mitigation (8)	.235**	.203**	.127	.137	.203**	.447**	-.016	1		
Risk Monitoring and Control (9)	.072	.033	.079	.129	.096	.514**	.067	.034	1	
Financial Performance (10)	.363**	.367**	.151*	.219**	.222**	.421**	.306**	.300**	.110	1

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

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

Source: Primary Data

Results in Table 3 indicate a significant and positive relationship between working capital management and financial performance ($r=.363$, $p<.01$). The results imply that enhancement of working capital management is associated with improvement in financial performance. Worth noting, working capital management has subcomponents of receivables management, payables management, cash management and inventory management. Further analysis reveals a significant and positive relationship between receivables management ($r=.367$, $p<.01$), payables management ($r=.151$, $p<.05$) and financial performance. The relationship between cash management and financial performance obtained correlation ($r=.219$) at 99% significance level ($p<.01$). Whereas, statistics reveal correlation ($r=.222$) at a 99% significance level ($p<.01$) in relation inventory management and financial performance. The above results signify that each constructs of working capital management relate with financial performance. Therefore, the results above address research question one.

Discussion of Findings

The findings revealed that working capital management is positively associated with financial performance. Businesses which effectively manage inventory, cash, receivables and payables are likely to minimize the risk of illiquidity and maximize profitability. This study further portrays that current assets and current liabilities are

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substantial drivers of profitability, liquidity and solvency. Accordingly, the study suggests that companies must ensure effective working capital management in order to reduce tendencies of illiquidity and decline in profitability. The findings are consistent with Sumathi (2016) who concludes that there is working capital management plays a commendable role in boosting financial performance among firms. Indeed, working capital management is regarded as the life-blood of any business irrespective of size and sector since it directly determines the success of routine business activities (Abuzayed, 2012; Marttonen et al., 2013). In the same vein, the study demonstrates that because working capital management is a net off of current assets and current liabilities, the ultimate potential of any company depends on its ability to put policies in place that can ensure that current liabilities are minimized as current assets are maximized.

This study also established that receivables management is positively associated with profitability and liquidity. On the face value, the findings depict that it is necessary for companies to engage in effective receivables management in order to improve their businesses in financial sense. These actions can be performed could be exhibited in terms of monitoring of debtor's due dates, offering some form of discount to customers who fulfill their obligations timely and formulating and sticking to a policy which indicates maximum credit a company is able to extend to its customers. Indeed, previous scholars in advocacy of receivable management practices are widespread. Empirical study by Anser and Malik (2013) indicate that it is important to manage receivables since it comprises the largest share of current assets. Similarly, Wang et al., (2013) who postulate that receivables planning models enhances forecasting and efficiency in working capital management which subsequently influence financial performance. A plausible explanation for the finding is that second car trading companies need to improve their communication with customers especially by providing clarity of credit terms before extending credit and consistently conduct outstanding debtors.

On the other hand, the findings postulate that how companies manage their cash has consequential implications on the level of financial performance. As a matter of emphasis, the findings indicate that indeed "revenue is vanity, cash flow is sanity but cash is king" as stipulated by CIMA (2015, p 25). With effective cash management, cash planning and cash monitoring and control are bound to become intense. As such, it is expected that companies would ensure that they budget and plan how they intend to spend cash, possess enough cash for day to day operations and effectively ensure that all cash spent is recorded and documented. From this perspective, the study elaborates that companies are more likely to pay creditors within the agreed time frame, minimize operational expenses and tendencies of operation on borrowed funds, which are core parameters of a financially performing company. This provides evidence earlier noted by Doan et al., (2016) that one of the inevitable attributes of working capital management is cash management. Also, McCabe *et al*, (2012) observes that cash management determines sustainability and survival of small businesses.

Additionally, the findings noted a positive relationship between payables management and financial performance. This suggests that financial performance of is driven by the efforts directed by companies in the management of

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payables. This is consistent with Orobia et al., (2013) who revealed that working capital management is a potential variable which enhances financial performance since it enables firms to meet short term obligations and invest in short term assets. Importantly, the study reveals that when there is a clear plan for handling debts such that suppliers are paid on time to improve the company-supplier relationship which would prove necessary for extension of future debts. As a result, it is projected that accrued expenses would be minimized to improve solvency. Consistent with the findings, Dong and Su (2010) postulate that proper working capital management enhances the firm's ability to create a balance between short-term assets and short-term liabilities.

Furthermore, inventory management and financial performance were found positively related. This demonstrates that inventory management as one of the components for working capital management should be part and parcel of within a company's setting. Worth noting, inventory management's primary focus is to minimize costs associated with holding either high level or low levels amount of stock at a given time. The positivity between inventory management and financial performance therefore implies that companies should ensure a trade-off between these extremities. In the same regard, Elsayed (2015) also observed that efficient management of inventory in a firm plays a vital role in deciding a firm's ability to operate with good profit margins. In addition, Ata, Buğan and Kılıç (2013) observed that proper inventory management promotes business continuity and company's success.

Conclusions

The study demonstrates that working capital management is indispensable in predicting financial performance. This expresses the urgency for exhibiting effective cash, inventories, receivables and payables. It is further postulated that risk management is significant in influencing financial performance. Thus, companies must conduct proper risk assessment, risk mitigation and formulate a clear system for continuous monitoring and control of risks to become liquid, profitable and solvent.

Recommendations

Risk monitoring and control should be intensified through reviewing risk policies and procedures. Companies should therefore seek feedback from employees regarding the effectiveness of controls and best strategies to guide the invention of proactive actions towards risks.

Adopt different risk mitigation methods in order to intensify financial performance. It is necessary for companies and individual car traders to evaluate all the risk encounters and categorically determine which risks to transfer, avoid or accept.

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