INTERNATIONAL JOURNAL OF SOCIAL Sciences and Information Technology
ISSN 2412-0294 www.ijssit.com

http:// www.ijssit.com

EFFECT OF DEBTORS MANAGEMENT ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KISII COUNTY, KENYA

[1*] **Geoffrey Nyabuto**
geophry3@gmail.com

[2**] **Julius Miroga**
juliusmiroga@gmail.com

[1,2] *Jomo Kenyatta University of Agriculture and Technology, Kenya*

Abstract: *Small and Medium Enterprises (SMEs) significantly contribute to economic growth by expanding employment, fostering development, and providing essential services. Despite their importance, SMEs in Kenya face numerous challenges, particularly in debtors' management, which affects their financial performance. This study investigates the effect of debtors' management on the financial performance of SMEs in Kisii County, Kenya. Utilizing an explanatory research design, the study sampled 89 SMEs using a semi-structured questionnaire to collect primary data. Reliability of the data collection instrument was confirmed with Cronbach's Alpha values exceeding 0.7 for all variables. Descriptive statistics revealed that effective debtors' management practices, such as timely debt collection and thorough vetting of borrowers, are crucial for SME financial performance. Correlation analysis indicated a positive and significant relationship between debtors' management and financial performance ($r = 0.794$, $p < 0.01$). Regression analysis further demonstrated that a one-unit improvement in debtors' management practices leads to a 40.1% increase in financial performance. The study concludes that robust debtors' management strategies are essential for enhancing the financial performance and sustainability of SMEs in Kenya.*

Keywords: *debt management, financial performance, small and medium enterprises, working capital management*

1. Introduction

Small and Medium Enterprises largely contribute to an economies economic agenda by expanding employment, fostering growth and providing crucial services. Sanders (2011) observe that SMEs critically contribute to growth of economies from global, regional to the local stages. A World Bank Report on SMEs (2015) observes that approximately 60% of the employment in developing economies is premised upon the small and medium entities. In addition, approximately 40 percent of national income in these countries is attributable to SMEs. Regionally, the African Development Bank (ADB, 2018) observe that as Africa reaches the billionth person mark, SMEs will serve a pivotal role in supporting its economy to host the growing population.

Nonetheless, the Kenya Private Sector Alliance (2017) reports that SMEs are facing a mountain of challenges and are struggling to register growth. Bowen, Morara and Mureithi (2009), found that most SMEs in Kenya have a sluggish growth rate and sixty percent of all SMEs will fail in their first year of existence. KNBS (Kenya National Bureau of Statistics) (2016) indicate that approximately 500,000 SMEs in Kenya close doors every

ISSN 2412-0294
Vol X Issue V, May 2024

year. Further the KNBS report observe that approximately 2.2 million SMEs collapsed between the year 2012 and 2016.

The management of debtors is crucial for the financial performance of small and medium enterprises (SMEs) in Kenya. Effective debtors' management practices can significantly impact the overall financial health of SMEs. Research has shown that practices such as Cash Management, Debtors’ Management, Creditors’ Management, and Inventory Management are positively correlated with the financial performance of businesses (Njoroge & Opuodho, 2022). Additionally, the impact of financial management practices on sustainable growth has been highlighted, emphasizing that poor financial management can have a negative effect on SMEs' performance (Chisiri & Manzini, 2022).

Furthermore, access to finance is essential for the growth and profitability of SMEs, as it facilitates business creation, innovation, and overall economic development (Abdulsaleh & Worthington, 2013). Studies have also explored the influence of factors like entrepreneurial skills, equity finance, and alternative financing on SME performance (Albanus et al., 2022; mwende et al., 2019; Waweru et al., 2018). Moreover, the COVID-19 pandemic has highlighted the resilience of SMEs, with factors such as business diversification, technology leverage, and cost management being identified as critical for SME survival during challenging times (Ahmed et al., 2021).

In the context of Kenya, where SMEs face various challenges including access to credit, the impact of debtors' management on financial performance becomes even more significant (Waweru et al., 2018). Understanding how SMEs manage their debtors, especially during crises like the COVID-19 pandemic, is crucial for ensuring the sustainability and growth of these enterprises (Syihab & Dalimunthe, 2022; Masago et al., 2020). Therefore, investigating the effect of debtors' management on the financial performance of SMEs in Kenya is essential for providing insights that can help these businesses thrive in a competitive environment.

2. Problem Statement

The Small and medium-sized enterprises in Kenya often struggle with optimizing their debtors' management practices, leading to cash flow issues, increased financial risks, and hindering their overall financial performance Karadağ (2015). Poor financial management is a significant contributor to business failures in SMEs, highlighting the critical role of effective debtors' management in ensuring the sustainability and success of these enterprises (Ates et al., 2013). Additionally, limited access to credit is a notable challenge for SMEs in Kenya, further emphasizing the importance of exploring how debtors' management practices influence the financial performance of these businesses.

The COVID-19 pandemic has worsened the financial challenges faced by SMEs, underscoring the necessity for robust debtors' management strategies to navigate economic uncertainties. Understanding the specific issues related to debtors' management in the context of SMEs in Kenya is crucial for developing tailored solutions that can enhance their financial performance and resilience. Therefore, investigating the relationship between debtors' management practices and the financial performance of SMEs in Kenya is essential for providing insights that can support the growth and sustainability of these businesses in a competitive business environment.

ISSN 2412-0294
Vol X Issue V, May 2024

3. Study Objectives

The general objective of the study was to determine the effect of working capital management on financial performance of Small and Medium Enterprises in Kenya with a specific objective to establish the effect of debtors management on financial performance of Small and Medium Enterprises in Kisii County.

4. Related Studies

Wekesa (2018) assessed the effect of debtors management practices on growth of small and medium sized entities in Kenya. The target population comprised all 1187 registered hire purchase businesses across different counties in the Kenya. A sample size of 305 was drawn from the target population using Cochran's formula. Both primary and secondary data were collected. The study results relatively indicated that credit approval practices, credit worthiness practices, credit administration practices and collection policy activities practices growth, all had significant influence on the growth of small businesses. Conceptually, gaps arise as the study considered a narrow framework of working capital management biased upon debtor's management thus leaving out other important aspects such as cash, payables and inventory management.

Njuguna (2018) studied WCM and growth of construction and allied sector firms listed at NSE, Kenya. The study considered the period between 2012 and 2016 and relied on a population of five companies. Specifically, it considered debtors' management, cash management and creditors' management as the components of the management of working capital. A combination of descriptive survey and explanatory research design was employed. A census survey was carried out. Regression analysis results showed that an average collection period as an indicator of debtors management had a low correlation with growth. In context, gaps are established on need to carry out a recent analysis considering the current period as the operating environment might have changed.

Okech and Ndagijimana (2014) studied the impact of working capital management practices in small and medium enterprises in Nairobi. Specifically, the study analyzed the management of accounts receivables and payables, and the CCCs (cash conversion cycles) and how they affect growth of SMEs. A descriptive survey research design was utilized and the population composed of SMEs in Nairobi County, Kenya as registered with Federation of Small and Micro Enterprises. Results established a positive relationship in business growth and the management of receivables.

Hassan, Ali, Abubakar and Ibrahim Naala (2018) studied working capital management and growth of Malaysian SMEs. The study explored the impact of cash management, inventory management, creditors' management and debtors' management on growth dimensions of SMEs performance. SMEs growth was indicated by the profitability metrics (ROA and ROE) and SMEs benefit intermediaries. Results established a significant association between debtors' management and SMEs' growth. In addition, results demonstrated a negative relationship between Days Account Receivables and growth of SMEs. On methodology, the study brings out gaps in that the study relied on purely quantitative data. By so doing, important qualitative dimensions of working capital and growth could have been missed in the analysis.

The Masocha and Dzomonda (2016) empirical analysis assessed the role of prudent working capital management on the SMEs' growth prospects. The study used a descriptive survey research design on a sample of 50 SMEs in Polokwane Municipality of South Africa. Through descriptive and inferential statistics, the study determined that debtors' management along with cash and inventory management had statistical significance in determining the growth of SMEs in South Africa. In context, gaps are clear in that the study,

ISSN 2412-0294
Vol X Issue V, May 2024

like most others are clustered in foreign set ups. Regarding the conceptual approach, a key working capital component; accounts payables was omitted in the assessment thus need to adopt a comprehensive approach.

The Motlíček and Martinovičová (2014) study explored the role of working capital management and business growth. A survey of 17 medium sized firms producing machinery and equipment. The survey was carried out in sales growth as the choice indicator of business growth. The specific working capital management features assessed in the study were receivables management and inventory management. The findings revealed a strong and positive relationship between debtors' management and enterprise sales' growth. Empirically, the study focused on only sales dimension of growth leaving out other facets of enterprise growth (assets and profit growth) inadequately covered in past literature. Conceptually, gaps emerge in that other key aspects of working capital management including cash management and payables management are not addressed. In context, the study, have a foreign orientation, with scanty evidence available in the local environment.

5. Research Methodology

The current investigation was conducted using an explanatory research approach. The research approach is thought to be effective in determining the influence of working capital management on SMEs' profitability in Kisii County, Kenya. According to Bell, Bryman, and Harley (2022), an explanatory study design is effective in explaining why a particular problem or condition exists. It elucidates the cause-and-effect relationships between the variables being researched. According to Bulmberg, Cooper, and Schindler (2011), an explanatory research design would aid in explaining the correlations that exist between variables of interest by answering the what, why, how frequently, and when of a phenomenon. As a result, the research design was beneficial to the study because it aided in elucidating the implications of working capital management and SMEs' profitability.

The study targeted a population of 841 SMEs in Kisii County. The study adopted the Trek (2015) formula to identify a statistically representative sample from the overall population. The formula is presented as:

$$n = N/ 1+N (e) 2 \qquad (1)$$

Where: n- Sample Size N-Population Size

e- Level of Precision at 90 percent Confidence level. Using the formula, the sample size is determined as follows;

n = 841/ 1+841(0.1)2 = 89.37. Hence, this is rounded off to 89 SMEs.

A semi structured questionnaire comprising of likert structured questions was used in collecting primary data. Mugenda and Mugenda (2012) opines that a questionnaire is advantageous in data collection in that it is cost effective and easy to administer. A drop and pick approach was used to administer the questionnaire to the respondents. Through this method, the researcher delivered the questionnaires in person to the respondents.

6. Reliability of the Data Collection Instrument

The initial assessment conducted on the gathered data following the pilot study focused on evaluating its reliability. Reliability of an instrument, as defined by Fraenkel and Wallen (2013), pertains to the consistency of scores or responses across different administrations of the instrument and across different sets of items. In this research, the Cronbach's Alpha (α) was employed as the method to assess instrument reliability. As noted by Mugenda and Mugenda (2013), Cronbach's Alpha (α) serves as a measure of the extent to which all the variables within the scale are positively correlated with each other. A reliable coefficient typically falls within the range of 0.00 to 1.00. A coefficient of 0.00 indicates a lack of consistency in the measurement, whereas a coefficient of 1.00 signifies perfect consistency in the instrument. However, adhering to the guideline put forth by Nunally (1978), a generally accepted standard for measuring Cronbach's Alpha is that it should exceed 0.7, indicating a high and practical level of internal consistency in the responses.

Reliability results based on Cronbach's alpha are presented in Table 1.

Table 1: Reliability of Research Variables

Variable	Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	Items	Conclusion
Debtors Management	.851	.849	2	Reliable
Financial Performance	.826	.845	2	Reliable

This study objective was measured by 2 items. Results in Table 1 above indicate that the 2 items had a Cronbach's alpha of 0.851 and 0.826. which means that all the items were reliable and were adopted for the main study.

Descriptive Analysis of Debtors Management and Financial Performance

The study's second objective was to establish the influence of debtors' management and financial performance. The descriptive statistics for the objective are shown in Table 2.

Table 2: Descriptive Statistics of Debtors Management and Financial Performance

Statement	SD	D	N	A	SA	Mean	Std. Dev.
The business's credit administration decisions are informed by a detailed trade credit policy.	7.5%	16.4%	12.5%	51.8%	11.8%	3.43	1.12
The debt collection system utilized by the SME ensures timely and accurate receipt of payments from creditors.	5.2%	9.2%	13.4%	57.0%	15.1%	3.67	1.01
The small business has a solid method in place for vetting prospective borrowers before extending credit.	4.3%	11.1%	12.5%	49.5%	22.6%	3.75	1.05
The SME maintains accurate records of its debtors in order to facilitate monitoring and provide data regarding the creditworthiness of borrowers.	9.8%	18.4%	41.5%	20.5%	9.8%	2.32	1.17

To guarantee timely debt repayment, the SME has instituted a stringent delinquent control system.	11.1%	19.7%	32.8%	27.5%	8.9%	3.23	1.19

As the findings in Table 2 portray, respondents were indifferent on the statement that business's credit administration decisions are informed by a detailed trade credit policy (Mean = 3.43, SD = 1.12). However, the respondents agreed to the statement that debt collection system utilized by the SME ensures timely and accurate receipt of payments from creditors which was indicated by a Mean of 3.67, SD = 1.01) and the one that small business has a solid method in place for vetting prospective borrowers before extending credit indicated by a Mean of 3.75, SD = 1.17. Moreover, they agreed to the statement that SME maintains accurate records of its debtors in order to facilitate monitoring and provide data regarding the creditworthiness of borrowers indicated by a Mean 3.23, SD = 1.19). Generally, the respondents seemed to agree that debts affects financial performance.

7. Correlation Results

The present study utilized correlation analysis to explore the relationship between variables, as Pallant (2010) recommended. The study adopted the following regression model.

$$Y = \beta 0 + \beta 1X1 + \mathcal{E} \qquad (2)$$

Where:

Y=Financial Performance

$\beta 0$ = Intercept

X1 = Debtors Management

$\beta 1$ = Regression Coefficients

$\mathcal{E}$ = error term.

A correlation value +1 signifies a strong positive linear association between two variables, whereas a correlation coefficient -1 suggests a strong negative linear association. Conversely, a correlation value of zero indicates the lack of a linear association between the two variables. The results of the correlation study are presented in Table 3.

Table 3: Correlation between Study Variables

	Y	**X_1**
Y	1	
X_1	.794***	1

Note: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

A variety of interpretations can be drawn from the facts presented in Table 3. In the beginning, it can be observed that the correlation coefficients among the independent variable X1 frequently exhibit values that are less than 0.50, which indicates that there are no substantial multicollinearity problems among these variables. According to Gujarati and Porter (2019), multicollinearity is defined as a phenomenon that is characterized by a correlation coefficient that is more than 0.80.

A correlation coefficient of 0.794 suggests that there is a positive and substantial association between debtors' management and financial performance. This shows that if the degree of debtors' management is increased financial performance is affected by 0.794 units.

Table 4: Regression Coefficients

		Unstandardized Coefficients		**Standardized Coefficients**		
Model		**Beta**	**Std. Error**	**Beta**	**t-stat**	**Sig.**
1	(Constant)	0.376	0.286		1.315	.002
	X_1	0.401	0.154	0.421	2.600	.021

Dependent Variable: ***Y***

Fitted Model: $\boldsymbol{Y = + 0.401 X_1}$

The results in of the regression analysis that are provided in Table 4 show that debtors management has a statistically significant beneficial influence ($\boldsymbol{\beta}$ = 0.401, p = 0.038) on financial performance. This suggests that when all other parameters remain the same, a one-unit increase in debtors' management leads to a significant 40.1% rise in financial performance.

8. Summary of Findings

The study objective sought to investigate the effect of debtors' management on financial performance of Small and Medium Enterprises in Kisii County, Kenya. The results of the regression analysis that are provided that debtors' management has a statistically significant beneficial influence on financial performance.

The study concludes that at the existence of a beneficial connection between the cash management and financial performance. The study concludes as well that there is a positive and substantial association between debtors' management and financial performance.

References

Abdulsaleh, A. and Worthington, A. (2013). Small and medium-sized enterprises financing: a review of literature. International Journal of Business and Management, 8(14). https://doi.org/10.5539/ijbm.v8n14p36

Ahmed, E., Kilika, J., & Gakenia, C. (2021). Sme resilience to covid-19. International Journal of Finance & Banking Studies (2147-4486), 10(4), 24-39. https://doi.org/10.20525/ijfbs.v10i4.1399

Ates, A., Garengo, P., Cocca, P., & Bititci, U. (2013). The development of sme managerial practice for effective performance management. Journal of Small Business and Enterprise Development, 20(1), 28-54. https://doi.org/10.1108/14626001311298402

Bell, E., Bryman, A., & Harley, B. (2022). Business research methods. Oxford university press.

Bowen, M., Morara, M., & Mureithi, M. (2009). Management of business challenges among small and micro enterprises in Nairobi-Kenya. KCA journal of business management, 2(1).

Chisiri, T. and Manzini, S. (2022). Impact of financial management practices on sustainable growth of smes: a case of catering organizations in Bulawayo metropolitan province. International Journal of Entrepreneurial Research, 4(3), 48-53. https://doi.org/10.31580/ijer.v4i3.2042

Karadağ, H. (2015). Financial management challenges in small and medium-sized enterprises: a strategic management approach. EMAJ: Emerging Markets Journal, 5(1), 26-40. https://doi.org/10.5195/emaj.2015.67

Masago, M., Okombo, M., Alice, S., Reuben, K., Chaka, B., Bulitia, G., & Joshua, O. (2020). Effects of covid-19 pandemic on small & middle-income economies (smes) in developing nations: a case study of Narok town, Kenya. Dutch Journal of Finance and Management, 4(2), em0067. https://doi.org/10.29333/djfm/9301

Mathuku, P. (2022). Effect of entrepreneurial skills on organizational performance of small and medium enterprises in Nakuru city- Kenya. International Journal of Economics and Business Administration, X(Issue 3), 156-173. https://doi.org/10.35808/ijeba/782

Motlíček, Z., & Martinovičová, D. (2014). Impact of working capital management on sales of enterprises focusing on the manufacture of machinery and equipment in the czech republic. Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis, 62(4), 677-684.

Njoroge, G. and Opuodho, G. (2022). Relationship between working capital management practices and financial performance by registered property developers in Kenya. International Journal of Finance, 7(3), 1-24. https://doi.org/10.47941/ijf.938

Syihab, H. and Dalimunthe, Z. (2022). Why did borrowers apply for debt restructuring during the covid-19 pandemic?. https://doi.org/10.2991/aebmr.k.211226.021

Waweru, J., Waweru, K., Wanjau, K., & Kinyanjui, J. (2018). Influence of alternative financing on the relationship between managerial competency and efficiency of small and medium enterprises in Kenya.

International Journal of Finance & Banking Studies (2147-4486), 7(1), 13-26. https://doi.org/10.20525/ijfbs.v7i1.15

Mwende, M., Muturi, W., & Njeru, A. (2019). Effect of equity finance on financial performance of small and medium enterprises in Kenya. International Journal of Business and Social Science, 10(7). https://doi.org/10.30845/ijbss.v10n7p13