

Effects of Financial Management Practices On Profitability of the Tea Firms in Kenya: A Case of Ktda Factories in Kisii County

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Abstract

The purpose of the study was to examine the effects of financial management practices on profitability of tea firms in Kisii County, Kenya. The specific objectives were; to establish the effects of cash management on profitability of tea firms, to evaluate the effects of inventory management on profitability of tea firms. The study adopted Agency Theory and Free Cash Flow Theory and was done in Kisii County. The study adopted descriptive research design. The target population was 48 employees comprised of tea firms. Census method was used to select 48 employees as the sample of the study. Questionnaire was used to collect primary data. Secondary data was collected through financial records for the last five years of operations. The collected data was edited, coded and analyzed by use of descriptive statistics such mean and standard deviations. The study used inferential statistics such as correlation analysis and regression models to establish the relationship between variables. The analyzed data was presented by use of tables and figures. The study found that the majority of employees working in tea factories were well educated with at least form four qualifications. Liquidity is essential for cash management of the company. Increasing cash collection increases cash levels in the tea factory. The study concluded that inventory management practices affected profitability of tea firms in Kisii county. However, the study concluded that required stock levels are used to improve production process which increases sales. Stock held increases customer's loyalty in the factory is only little. The study recommended that proper debtor records should be embraced by tea firms with variation in outstanding debt annually. Debtor collection period should be measured by reporting periodical returns. Further, using internal rate of return tea firms should embrace in proper financing. Profitability index should ensure risk investment is avoided. Firm should downsize labor costs to increase profits. Further the firm should use cost reduction strategy to increase revenue. Another study can be conducted to examine the effect of financial management practices on financial performance in other firms.

1. Introduction

Financial management was started from 1973 to 2016 (end of current replenishment period) in Asian Development Bank financial resources. It is a way of using credit gateway as deposit program for the receipt of federal agency Fedwire Automated clearing house credit transactions. However, profitability of tea factories is declining over the years. It is based on the practices of musing sources of funds. Financial management include; investment, receivables management, financing, accounting information systems and financial reporting and analysis (Myers, & Brealey, 2003).

In United Kingdom, cash management is concerned with all areas of financial management, which involve not only finance sources, but also uses of finance and their implications in

investment, production, marketing or human resources decisions and the overall performance of the firm (Maseko, & Manyani 2011). Owners tend to manage these cash for themselves as a measure of reducing operational costs. Lack of effective financial management practices during firm's early stages is also a major cause of firms' failure for low profitability. Though, such areas are not currently well embraced by firm profitability in developing countries which creates an urgent attention needs (Hutchinson, 2017).

In USA, inventory management is a component of financial management practices which have brought challenges in performance of firms in United States of America. The inventory management affects financing, investing and payment decision. It also observed that financial management is not only the sources, but also uses of financial implications on the practices. Lack of effective inventory management during the firm's early stage is a challenge resulting business failures. Though, investors and owners tend to manage inventory as means of maintaining stock cost incurred. However, efficient inventory management lacks supporting evidence to help firms to strengthen their profitability to overcome difficulties (Ross, 2009).

In Malaysia, inventory management is growing issue of financial management practices in many firms that hinges profitability value. This indeed is not well established and evolved from financial management practice to boost for profitability as it provides long-term and short term cash. In this context of business firms, financial management practices is critical areas like, capital expenditures, costing, and cash management by providing information to help monitoring and control. It aims at all levels of the firm; budgets are getting inventory cost estimation in timely, reliable and accurate financial management information for decision (Mohamad, 2010).

In Kenyan firms, it rather unfortunate that firms do not rely on investment decision in their cash surplus in the money market make for profit, since these firms have little knowledge on put in investment decision in the money market (Matthijs 2012). This is because the contributing to the discrepancy in profitability measured by profit margin and sales, where investment returns has negative effect of profitability of the firms; hence financial management practices have an effect on the firm's profitability for financial managers to pay much attention. The implications of different inventory management practices have affected profitability levels in many firms in Nairobi. This included average cash collection period, cash for inventory management, current ratio and how they affect net profits from operation. The inventory management is one of financial management practices based on profitability and average cash collection period and cash conversion cycles for 50 firms. This has no significant variation on the effect of inventory management on profitability in Nairobi firms (Nyongesa 2017).

Profitability of Tea factories in Kenya has remained low for many financial periods as result of the problem of poor financial management practices. These tea firms are generally achieving small and have low returns on asset. The tea firms being among the largest users of financial management practices are therefore faced with the problem of profitability.

1.2 Statement of the Problem

Evaluating financial management is part of managing investments and limiting risk. It involves selection of the decision on what factory asset to buy stock, how much, when to sale and what to invest (Marthijs 2012). Nyongesa (2017) disputed that when financial management becomes more difficult, the firm has few resources to utilize or change programs and reduce number of

cost initiatives to undertake. It is still being critical to ensure efficiency and sustain profitability aspects. Despite this, Tea firms are experiencing decline in profitability levels over the years. This is attributable to their inability to solve the problem of managing cash, inventory, receivables and investment decision in tea factories in terms of financial management practices. The firms have applied various financial management practices yet their profits are declining from the year 2013 at Ksh. 23.14 and in the year 2017 it decreased to 21.09 percent due to lack of cash management, inventory management, receivables and investment decisions (KTDA Report 2017).

1.3 Objectives of the study

- i. To establish the effects of cash management on profitability of tea firms in Kisii County, Kenya.
- ii. To determine the effects of inventory management on profitability of tea firms in Kisii County, Kenya.

2. Theoretical Reviews

2.1 Agency Theory

This theory was proposed by Berle and Means in 1932. The theory states that the relationship interest between the management and the shareholders are in the conflict of agency costs incurred. The agency problem arises from the contractual relationship between the principal (shareholders) and the agent (management) enhances profitability. The following are the consequences of the agency conflict between stockholders and the management which may lead to a decrease in the value of the firm. First, managers, may award themselves high salaries and benefits and they may not work hard to maximize the shareholder's wealth. Managers undertake their self-image at the expense of profitability and sometimes they may not choose exposing shareholders to unwarranted risk (Wagoki, 2014)

The assumption of agency theory is that agency is the firm's value is not maximized end up being undertaken because of self-interest. Though the agency problems could lead to loss to the shareholders, there arose a problem on how to define and quantify agency costs. The three agency costs incurred as suggested are: monitoring cost of investment actions, bonding cost of investment covenants. The theory asserted that there is a relationship between free agency problems, since managers are likely to investment risk free of financial sources at their disposal in the absence of profitable projects in order to invest to the shareholders (Darek 2012).

The weakness of the theory is based on the approaches used to solve the agency problem through the nonparticipation approach and the encouraging approach. The increase debt financing by the firm could lead to a substantial decline. The means of using agency interest since managers are legally bound to pay interest and the principal repayment which reduces the misuse of free cash flows. The threat corporate takeover could discourage managers from making sub-optimal decisions (Mugori 2012).

The use of this theory is that of relevance to explain the s returns to shareholders in the form of stock repurchase or dividend payments are adherents to the encouraging management part to be the owners of the company, either by issuing shares to them could make them make decisions which are in the best interest of the shareholders. It informs the relationship between financial management practices and profitability of firms using agency costs.

2.2 Free Cash Flow Theory

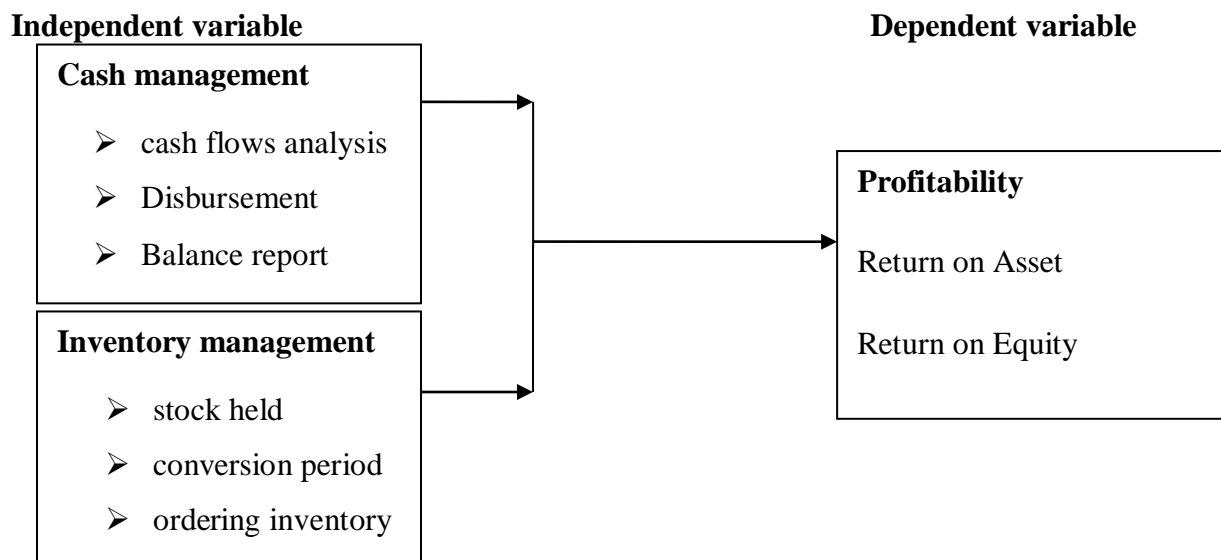
This theory was propounded by Jensen in 1986. It states that funds are received and spend over operations and management practices. The management of firms expects high free cash flows likely for more return on investment which is worth to the firm. Financial managers show how the flow of money on above to invest or below to invest in the budget line of which force for capital expenditure of the investment companies on their net present project value. This is how free cash flows are termed to maximize wealth and efficient cash distributions to shareholders in the form of the investment returns (Chijah and Forchu (2010).

The assumption of the theory is based is that the techniques to reduce payment of cash is to increase investment from maximum returns subjected from capital markets. Using internal investor of cash flow will assist to reduce cost incurred. Maximizing profit is at the expense of wealth drive as to cash managers sought to expand firm. The expansion of investment results increase of costs under the cash flow models resulting to pay positively in relation to growth. The tendency for investment over how to invest to price cost (Bano 2011).

The limitation of the theory is that cash flow theory is only financial management that s motivates investors to invest in their cash managers to be more efficient in order to improve profitability.

2.3 Conceptual Framework

Conceptual Frame work shows the relationship between independent and dependent variables. The figure 2.1 showed that a relationship between financial management practices and profitability of tea firms. The independent variable will be financial management practices.



Cash management was measured by cash flows analysis, Disbursement, Balance report, Inventory management with stock held, conversion period and ordering inventory, Receivables Management with debtors, Sales of goods, Outstanding invoices and Investment decision with dividend pay, Internal rate of return and Payback period. Profitability will be measured by Return on Asset, and return on asset. Financial management practices affect profitability.

2.2 Empirical Literature Review

2.2.1 Cash management in Profitability

Darek (2012) examined the effect of cash management and profitability of firms in Netherland. The aimed to examine the effect of cash management on profitability of firms, specific objectives were to find out the effect of depreciating assets on profitability, the effect of liquidity gaps on profitability and cash management policy on profitability. The study used 4 firms listed with secondary data collection instruments. The study analyzed data by means, corrections and regression analysis. The results indicated that liquidity is essential for company cash management existence. The significance of cash management to the company might lead to the conclusion that it determines the profitability level of the company. This issue was subject to many theoretical and empirical studies which were conducted but failed to apply descriptive statistics to analyze profitability of the company.

Erkki (2014) analyzed the effect of cash management efficiency on firm's profitability using telecommunications equipment industry in the United States. The study main objective was to analyze the cash management efficiency of firms using telecommunications equipment industry in the United States. The relationship between cash management efficiency and profitability was analyzed using correlation and regression analysis. ANOVA analysis was done to test the effect of cash management efficiency of firms on profitability using a sample of 12 firm's annual financial statements of 35 companies covering 2011 to 2017. This study found evidence that days using cash is negatively related to the profitability, it is not significant the profitability of companies. However, the study did not analyze data using descriptive statistics.

Kinyua (2013) studied the effect of different variables of cash management on profitability in Nairobi firms. The study aimed at assessing the effect of different variables of cash management on profitability. The specific objectives included average cash collection period, cash for inventory management, current ratio and how they affect net operating profitability. The study utilized panel data econometrics in a pooled regression analysis, with time series and cross-sectional observations were combined and determined. The study found a significant negative correction between net operating profitability and average cash collection period and cash conversion cycles for 50 firms. The study also found that there was no significant variation on the effect of cash management on profitability in Nairobi firms.

Galindo, (2013) conducted a study on the effect of cash management on financial performance of small enterprises in Kisii South District Kenya. The study used the following specific objectives; to examine the effect of working capital management on financial performance, debt ratio, current ratio and turnover ratio. Using panel data methodology and regression analysis, it was found that there was a significant negative correlation between profitability and debt ratio per cash ratio. However, the company conversion cycle, current asset ratio and size is significantly positively influence profitability. It was also found that efficient cash management leads to better financial performance of small enterprises. However, poor management, limited transparency in cash management of small enterprises led to weak capital base and infrastructure weakness in savings and liquidity demands.

2.2.2 Inventory management in Profitability

Bagchi (2012) analyzed the relationship between Inventory management on financial performance in the selected companies in India. The study aimed at analyzing the relationship between Inventory management on financial performance in the selected companies in India. The study selected a sample of 10 years from 2002 to 2012. The study adopted explanation variables statistics with fast moving consumer goods companies in India from. The questionnaire was used to collect data. The study used Pearson's correlation and pooled ordinary least square regression analysis to analyze data. The results confirm that there is a strong negative relationship between variables of inventory management and profitability of the firms. As the inventory management practices it increases cash conversion cycles to possible minimum level as the profitability decreases. Managers can create a positive relation for shareholders by reducing inventory cost.

Bano (2011) explored on of inventory management and profitability of the firms. As the financial management practice, the study aims to explore the effect of inventory management and profitability of Spanish small enterprises. The study sampled 131 listed firms on Athen stock exchange for period of 2001 to 2009. The study used correlation analysis and regression tests to measure profitability through gross operating profit and independent variable like financial debts and current ratio and size of the firms. Financial assets to total assets ratios are the selected independent variables and net inventory profits. However, the study found that there is negative relationship between inventory and profitability that demonstrates considerable nonlinear relations between variables.

Bhunja (2010) carried a study on inventory trend management on profitability in selected private sector Indian steel industry. The study sought to establish the effect of inventory trend analysis management in selected private sector Indian steel industry. The specific objectives were, to examine the effect of inventories to a reasonable minimum and age of inventory is consistent with the view that less profitable firms. The selected companies take an average of 5-7 day to sell inventory with a standard deviation of 37 days. Minimum time taken is an average of 5 days to pay their creditors with only 2 days, however, the minimum 3 days to a considerable value. The result showed that there was the relationship between inventory trend analysis management and in selected private sector Indian steel industry.

Ching (2017) examined the relationship between inventory management and profitability of Brazilian listed companies. The purpose of the study was to examine the relationship between inventory management and profitability of Brazilian listed companies. The study focused on the relationship between inventory management on profitability and dividend payout ratio. Financial data was obtained from 12 listed manufacturing firms in Nigerian stock exchange from 2012 to 2017. Using both pearson product moment of correlation technique and ordinary least square OLS regression technique, it was found that shorter net inventory trade cycle, debt ratio promotes high corporate profitability. While the level of inventory management has negative impact on corporate profitability, the impacts of inventory management on profitability appeared to be statistically insignificant at 5 percent confidence level. But the study failed to analyze profitability with tea factories using descriptive statistics.

Oladipupo and Okeri (2017) examined the effect of inventory management practices on its profitability. The study used a sample of 30 listed firms in NSE for period of 2013 to 2015. The both pooled OLS and the fixe effects regression models were used. The results show that there exist highly significant negative relationships between the time it takes for firms to collect cash

from inventory from customers and profitability. The more profitable firms take the shortest inventory time to collect cash from customers. This implied that there was high correlation between inventory conversion period and profitability. It was explained that firms which maintain enough inventory levels reduce costs of possible interruptions in financial management practices which reduce scarcity of products. The study finally indicated that average payment period and profitability was positively correlated to pay its creditors to increase profits.

3. Research Methodology

The study adopted descriptive research design. The target population of this study comprised of 48 respondents, because they were able to provide information required for the study. Census method was used to arrive at a sample size of 48 respondents.

The questionnaires were distributed to factories respondents through members of management and other staff to fill in; the researcher dropped and picked the questionnaires filled one by one from the respondents. Data analyses were analyzed by descriptive by quantitative analysis. Before the actual data, questionnaires were collected to determine if accurate sample that was obtained in terms of issued questionnaires filled fully. Descriptive statistics was analyzed using means, frequencies, percentages and standard deviations in tabled form. An inferential statistics method of simple and multiple linear regression analysis was used to determine the relationship between financial management practices and profitability of tea firms.

4. Results and Discussion

4.1 The effects of cash management on profitability of tea factories

The study sought to determine the effect of cash management practices on profitability of tea factories in Kisii County. Table 1 presented the results.

Table 1 Cash management

| | Mean | Std. Deviation |
|---|--------|----------------|
| My firm uses cash flow analysis to determine how much to invest to each activity | 3.5526 | 1.24548 |
| Timely cash flows analysis increases cash availability | 4.1579 | .75431 |
| Cash flow analysis helps in managing cash liquidity | 3.3684 | 1.21746 |
| Regular disbursement when due reflect true company cash levels | 3.6053 | 1.05368 |
| The increase in cash flows to the factor allows proper financial planning | 1.9211 | 1.19417 |
| Cash disbursement allows timely allocation of resources for financial growth | 1.8421 | 1.19744 |
| Increasing cash collection increases cash levels in the firm | 1.6316 | .71361 |
| Timely cash collections increases cash levels and customer confidence | 3.7368 | .82803 |
| Cash disbursement reports leads to proper cash management practice | 3.7895 | 1.01763 |
| Liquidity is essential for cash management of the company | 4.2895 | .95600 |
| Allocation of capital is easy with cash management | 4.0526 | .69544 |
| Cash collection increases cash level | 4.0263 | .94402 |
| Cash balance report helps in monitoring of cash management | 3.8684 | .77707 |
| The cash collection has high influence on shareholders access to dividends in tea factories | 3.9737 | .97223 |
| Cash collection records are regularly maintained | 3.7632 | 1.02494 |
| Valid N (listwise) | | |

The study showed that cash management in terms of liquidity is essential for cash management of the company had a mean of 4.2895 standard deviation of .95600 while Increasing cash collection increases cash levels in the firm with a mean of 1.6316 and standard deviation of .71361.

4.2 Inventory management

The study sought to evaluate the effects of inventory management practices on profitability of tea firms in Kisii county Kenya. The results were shown in table 2

The study showed that Required Stock levels is used to improve production process to increase sales with a mean of 4.2632 and standard deviation .75995, Tea firms order the right quantity managed by production manager with a mean of 4.1316 and standard deviation of .81111.

Table 4.6 Inventory management practices

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|----|---------|---------|--------|----------------|
| Stock held increases customers loyalty in the factory | 38 | .00 | 5.00 | 3.6842 | 1.14148 |
| Acceptable stock levels increases sales | 38 | .00 | 5.00 | 4.0526 | 1.03838 |
| Availability of stock held is enough to meet customers' needs | 38 | 1.00 | 5.00 | 3.8684 | 1.01798 |
| Good Inventory conversion cycles increases sales in factory | 38 | 1.00 | 5.00 | 4.0000 | .98639 |
| Inventory conversion period is enhanced by ordering enough stock to improve performance | 38 | 2.00 | 5.00 | 4.0000 | .92998 |
| Ordering inventory is based on fast moving consumer | 38 | 1.00 | 5.00 | 4.0000 | .92998 |
| Tea firms order the right quantity managed by production manager | 38 | 2.00 | 5.00 | 4.1316 | .81111 |
| Holding stocks helps in inventory management of the factory | 38 | .00 | 5.00 | 3.8421 | 1.10347 |
| Required Stock levels is used to improve production process to increase sales | 38 | 2.00 | 5.00 | 4.2632 | .75995 |
| Valid N (listwise) | 38 | | | | |

The study showed that required stock levels is used to improve production process to increase sales with the highest mean of 4.2632 and Stock held increases customer's loyalty in the factory had lowest mean of 3.6842.

The results from table 3 indicated the regression coefficient R .799, with R² .638. The coefficient of determination in dependent variable (profitability) was 63.8% which explains variation in the independent variable leaving out 36.2% unexplained for other studies.

Table 3 Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|-------------------|----------|-------------------|----------------------------|
| 1 | .799 ^a | .638 | .567 | .93353 |

a. Predictors: (Constant), Cash Management, Inventory Management

The regression coefficient was determined to establish the relationship that exists between variables. Table 4 Shows regression coefficients

Table 4 Regression Coefficients^a

| Model | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|----------------------|-----------------------------|------------|---------------------------|--------|------|
| | B | Std. Error | Beta | | |
| (Constant) | 4.861 | 1.001 | | 1.905 | .000 |
| 1 Cash Management | .717 | .277 | .005 | 11.022 | .003 |
| Inventory Management | .893 | .245 | .079 | 9.060 | .020 |

a. Dependent Variable: Profitability

The table 4 shows that a constant value of (4.861) implied that any change in financial management practices (Cash Management, Inventory Management) are all left at zero, as profitability was determined. X1 cash management represents is .717 indicated that a change in a unit of X1 results to 71.7% an increased profitability. X2 this represents inventory management spread with .893 which implied that unit change in inventory management results to 89.3% increase in profitability.

$$Y = 4.861 + .717X_1 + .893X_2$$

5. Conclusion and Recommendation

The study found that the majority of tea factory liquidity is essential for cash management of the company. Increasing cash collection increases cash levels in the firm.

The study concluded that inventory management practices affected profitability of tea firms in Kisii county Kenya. The required stock levels are used to improve production process to increase sales. Stock held increases customer's loyalty in the factory is only little.

The factories should embrace cash collection by cash levels. The cash management should be improved in tea factories for them to enhance financial management practices. The study recommended that tea factory should embrace the required stock levels to improve production process to increase sales.

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