

EFFECT OF CASH MANAGEMENT ON FINANCIAL PERFORMANCE OF DEPOSIT TAKING SACCOS IN KENYA

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ABSTRACT

This study sought to determine the effect of Cash management on financial performance of deposit taking SACCOs in Kenya. The objective of the study was to determine the effect of cash management on financial performance of deposit taking SACCOs in Kenya. The study employed a descriptive research design to study the population of 135 deposit taking SACCOs licensed in Kenya by 2013 where purposive sampling was used in selection of the research sample. The selected sample consisted of 56 among the 135 registered deposit taking SACCOs whose five years' data from 2013-2017 was employed in determining the effect of Cash management on financial performance of deposit taking SACCOs in Kenya. The data was obtained from the audited financial statements of respective SACCOs lodged with SASRA and were available in the regulator's website. Two linear regression models were employed by the researcher to bring out the effect of Cash management on financial performance. The significance of independent variable was tested using t- test while the overall significance of the model was tested using F- test at 5% level of significance. The study established statistically significant positive effect of cash management on both ROA and ROE with coefficients of 0.332 and 0.505 and p-values 0.001 and 0.001 respectively. The study concluded that deposit taking SACCOs should increase their cash levels since it impacted positively on financial performance. The findings of this study would be important to policy makers such as SASRA and SACCO directors in planning on their Cash holding levels.

Keywords: Cash Management, Financial Performance, Return on Assets, Return on Equity SACCO.

1.1 Introduction

Management of cash and the role it plays in advancing financial performance continues to steer debate among various scholars and researchers globally (Dalayeen, 2017). Cash management is

an important aspect of firm's operations and growth. It is the lifeblood and the controlling nerve centre for any type of business organization because without its proper control, no business can run smoothly (Joshi, 2013). In global context, in any organizational setting that requires lucid financial attention, sound planning and management competency, cash is a vital element (Alu, 2012). A positive cash management indicates the ability of a firm to pay off its short term obligations as and when they fall due. On the other hand, a negative cash management indicates a firm's inability to finance its short term debts when due (Singh & Asress, 2010). Nyabwanga (2011) describes cash management as the practice of ensuring proper plans and controls regarding cash that gets into and out of the business the business, cash flows within the business, and cash balances held by the business at a point in time. Efficiency in cash management entails the determination of the optimal cash to hold by considering the tradeoff between the opportunity cost of holding too much cash and the trading cost of holding too little (Ross, Westerfield & Jordan, 2016). Cash, just like inventories is a very significant component of working capital. Management of cash requires that firms decide on how much liquid capital ought to be used in the most optimal manner (Brigham & Houston, 2013). Sound planning and monitoring of cash flows over time is required so as to determine the optimal cash to hold. Holding excess cash however, impacts the cost of capital needed in financing maturing obligations. It is therefore imperative that a firm attains an optimum balance between cash at hand and the amount to be invested in marketable securities since cash deficits will most likely result in transaction costs (Brealey & Meyers, 2013). Cash ratio and cash conversion cycle are the main parameters used in measuring the firm's ability to manage its cash.

Financial performance refers to a measure of how sound a firm uses resources from its primary mode of business to generate revenues. It is a general measure of firm's financial health over a particular period of time and can be used to compare similar firms across the same industry or to compare performance of industries or sectors in accretion (Ongore & Kusa 2013). These results are reflected in the firm's return on assets, return on investments, return on equity, accounting profitability and its components (Bagarogoza & Waal, 2010). Return on assets is the commonly used performance measure by most researchers. It is defined as income available to ordinary shareholders divided by the book value of total assets. Return on Asset reveals the efficiency of management in generating income from various sources of the financial institution (Krawish & Al-sa'di, 2011). An increased ROA is thus attributable to improved management efficiency. Return on equity is defined as the income available to ordinary shareholders divided by shareholders equity (Donaldson, 2001). Ongore and Kusa (2010) explains that ROE signals the effectiveness of a financial institution in utilizing shareholders' funds. This implies that the better the ROE, the more effective the management is in utilizing the shareholders' funds. Theoretically, when other factors are held constant, it is expected that the level of investment in cash impacts on a firm's financial performance. Excessive investment in cash posts a negative

impact on financial performance of a firm and at the same time impacting on its liquidity. Conversely, low investment in cash impacts positively on firm's financial performance and at the same time, it exposes a firm to financial risks due to illiquidity problems (Ross, Westerfield & Jordan, 2016). Much of the studies have mainly focused on the effect of working capital management on financial performance of construction, manufacturing and commercial firms. Also most studies have not considered other measures of working capital components such as cash ratio. Instead, they have used measures such as cash conversion and accounts payable payment period. This study therefore bridges this gap by focusing on the effect of cash management on financial performance of deposit taking SACCOs in Kenya.

1.2 Statement of the Problem

Working capital management is a subject of concern in savings and credit cooperative societies (SACCOs). This is ideally because of the fact that SACCOs operate in the service sector where most of their operations are run through utilization of working capital components namely cash, accounts receivable and accounts payable. Without proper management of working capital components, it becomes difficult for SACCOs to run their operations smoothly and meet their day to day obligations. SACCOs ideally undertake the operation of working capital management with the aim of maximizing. This objective can be realized if SACCO directors have proper understanding and training of working capital management. However, the potential aim is not fulfilled by some SACCOs because of particular set of problems in their management. A report by world council of credit unions (2016) indicates that 1 out of every 2 SACCOs in developing countries faced problems with respect to working capital management. Vast majority of SACCOs either maintain excessive or inadequate working capital levels which are inappropriate. If this situation is not checked, the financial performance of these SACCOs will continue dwindling hence SACCO shareholders will not be able to realize value for their money. Considering the importance of working capital management, most studies have not focused on the effect of cash management on financial performance of deposit taking SACCOs. For example, Mathuva (2010) focused on the effect of working capital management on corporate profitability of firms listed at NSE. Gekure (2014) on the other hand focused on the relationship between working capital management and performance of manufacturing firms listed at NSE. These studies however provide no evidence on the effect of working capital management on financial performance of deposit taking SACCOs in Kenya. This study therefore seeks to bridge this glaring gap by finding out the effect of cash management on financial performance of deposit taking SACCOs in Kenya.

1.3 Objective of the Study

The study was guided by the following specific objective:

- i. To establish the effect of cash management on financial performance of SACCOs in Kenya

1.4 Research Hypothesis

H₀₁: Cash management has no statistically significant effect on financial performance of deposit taking SACCOs in Kenya

1.5 Significance of the Study

This study will be of great importance to SACCO Board of Directors as it will enable them to set a trade-off between the organization liquidity and its performance. They will also be able to exercise cash management practices from an informed position. The Sacco Societies Regulatory Authority (SASRA) and other regulatory bodies that are responsible for the licensing, regulation and supervision of deposit taking SACCOs, including policy formulation, monitoring and evaluation will make informed decisions on the basis of the findings, when executing their mandates with respect to management of cash and financial performance. The study shall have policy implications and recommendations which would be of great value to the government policy makers in development of policies that can create a conducive and enabling environment to savings and credits cooperatives operations in the country. Scholar and researchers would find this study as being of great interest since gaps for further research shall be provided at the end. The findings of this study will add knowledge to the field of financial management on the optimum levels of working capital that should be held by organizations especially SACCOs that would maximize the organizations' performance in terms of profitability.

2.1 Cash Management and Financial Performance

Kosgey and Njiru (2016) carried out a study on influence of cash management on the financial performance of SMEs in Nakuru County. The examination on whether cash management had statistically significant impact on financial performance of SMEs was done using linear correlation tests. The study findings revealed that Cash management had statistically significant positive effect on financial performance. This study however differs with the current one in that the study focused on SMEs whose operations differ from that of deposit taking SACCOs. The study by Njeru(2016) sought to find out the effect of cash management on financial performance of deposit taking SACCOs in Mt. Kenya region. A descriptive research design was applied on of 92 respondents. The target population was all thirty licensed deposit taking SACCOs in Mt. Kenya region, the sampling technique employed was simple random sampling technique. Information on cash management and financial performance of deposit taking SACCOs in Mt. Kenya region were collected where a questionnaire was employed as a data collection instrument. Primary quantitative data was selected by use of self-administered structured

questionnaires. The researcher also used a data collection checklist to collect secondary data derived from the audited financial statements of the SACCOs lodged at the regulator’s website (SASRA). The collected data was analyzed using both descriptive and inferential statistics. The findings indicated a statistically significant positive relationship between cash management and financial performance of deposit taking SACCOs in Mt. Kenya region. This was indicated by positive correlation of 0.584. The sample selected for this study was however too small and the results may therefore not reflect the performance of all deposit taking SACCOs in Kenya.

2.2 Conceptual Framework

A conceptual framework is a diagrammatic representation of the relationship between independent and dependent variables. The conceptual framework for the study is shown in Figure 1.

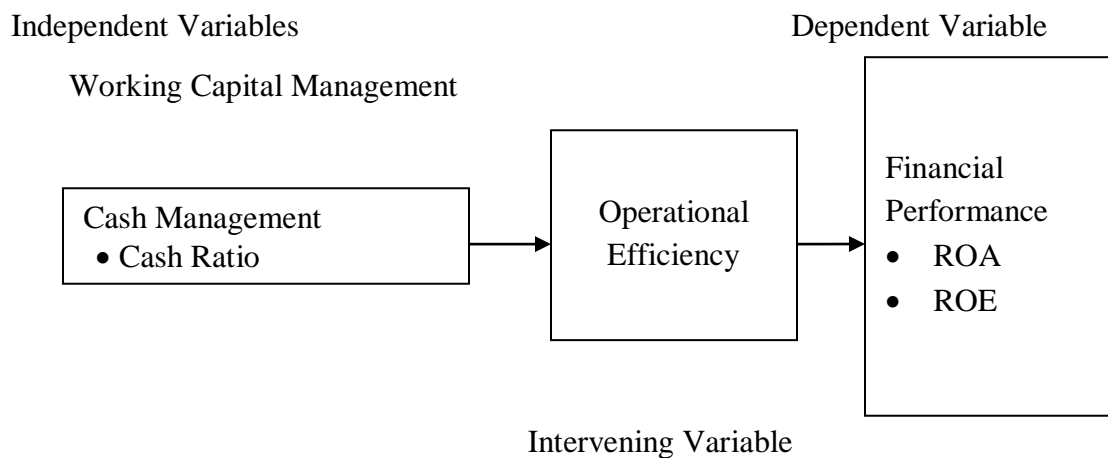


Figure 1: Relationship between Working Capital Management and Financial Performance

3.1 Research Design

This study adopted a descriptive research design

3.2 Population of the Study

The target population of the study was all the 135 deposit taking SACCOs in Kenya licensed by 2013 divided into 5 membership categories as indicated in Table 2.

Table 1: Population of SACCOs Licensed by SASRA as per Membership Categories

Categories	Number of SACCOs
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Government based SACCOs	27
Teachers based SACCOs	32
Farmers based SACCOs	44
Private institutions	18
Community based SACCOs	14
Total	135

Source: SASRA Handbook, 2013

3.3 Sampling Procedure and Sample Size

This study adopted purposive sampling in selection of research sample. The selected sample consisted of 56 out of 135 deposit taking SACCOs registered by 2013. The 56 registered deposit taking SACCOs selected for the study had complete data from 2013-2017. The suitability of purposive sampling was to pick only those firms that meet the purpose of the study. Table 3 shows the distribution of 56 deposit taking SACCOs sampled according to membership categories for the purpose of the study.

Table 2: Distribution of Sampled Deposit Taking SACCOs as per Membership Categories

Categories	Number of SACCOs
Government based SACCOs	10
Teachers base SACCOs	13
Farmers based SACCOs	18
Private institutions	8
Community based SACCOs	7
Total	56

Source: SASRA Website, 2013

3.4 Research Instruments

This study made use of a data collection checklist as the research instrument where the information with regard to cash, accounts receivable, accounts payable and return on assets were filled in.

3.5 Data Analysis

Multiple linear regression model was used to determine the cause- effect relationship among the variables under study. Estimated linear regression model was used to analyze the data where

hypotheses were tested using t-test while the overall significance of the model was tested using F-test at 5% level of significance.

4.1 Test of Overall Significance of the Model

The study sought to determine whether the model variables in overall were significant. The test of overall significance was done by use F- statistic test. If the computed p-value is less than the critical p- value (0.005), then there follows a conclusion that the variable coefficients are significant. The test results of the overall significance were presented in the Table 12.

Table 3: Test of Overall Significance of the Variables

Test – statistic	Statistic value	p- value
F – test statistic for model 1	670.514	0.000
F – test statistic for model 2	204.552	0.000

Results from table 12 indicated that model 1 in overall had significant variables since the computed p-value was 0.000 which is less than the critical p-value of 0.05 at 5% level of significance. It implied that the coefficient of the independent variables in overall were significant. Also the p value of the F statistic for model 2 was 0.000 implying that the coefficients of the independent variables were significant in overall at 5% significance level.

4.2 Model Estimation

The study sought to estimate the relationship between the explanatory variables and the explained variable. The estimation involved use of OLS method in SPSS to obtain a multiple regression model. Two models were estimated as below.

Model 1 (Working Cash Management and Return on Assets)

The dependent variable in this model was return on assets (ROA) while the independent variable was cash management as measured by cash ratio. The results on the coefficient estimates and p values of the coefficients were estimated in Table 4.

Table 4: Coefficient Estimates for Model 1

Variables	Coefficient Value	Standard error	t statistic	P value
Constant	-0.304	0.025	-12.114	0.001
Cash ratio	0.332	0.020	16.679	0.001

$R^2 = 0.581$

Results from Table 4 indicated that the constant of the model was -0.304, the coefficient of cash ratio was 0.332. The coefficient of determination (R^2) was 0.581. This implied that 58.1% of the changes in dependent variable is explained by changes in the independent variable. 41.9% of the changes in presumed effect (dependent) variable is explained by the error term. Therefore the explanatory variable was a good predictor to return on assets. The model was estimated as below

$$ROA = -0.304 + 0.332X_1$$

Where;

ROA = Financial performance as measured by Return on Assets, X_1 = Cash management as measured by Cash ratio.

From model 1, one unit increase in cash ratio leads to increase in return on assets by 0.332 units. The p value of the coefficient from table 13 was less than 0.05. This implies that the coefficient of cash ratio was significant at 5% level of significance.

Model 2 (Cash Management and Return on Equity)

The study also estimated the relationship between ROE and cash ratio using a linear regression model. The independent variable was cash ratio. The estimates were summarized in Table 5.

Table 5: Coefficient Estimates for Model 2

Variables	Coefficient value	Standard error	T statistic	P value
Constant	-0.218	0.067	-3.246	0.002
Cash ratio	0.505	0.053	9.506	0.001

$R^2 = 0.54$

From Table 5, the constant of the model was -0.218, the coefficient of cash ratio was 0.505. The coefficient of determination (R^2) was 0.54. This implied that 54% of changes in return on equity is explained by changes in the independent variables.46% of the changes in dependent variable is explained by the error term. Therefore the explanatory variable was a good predictor to return on equity. The model was estimated as below

$$ROE = -0.218 + 0.505X_1$$

Where;

ROE = Financial performance as measured by Return Equity, X_1 = Cash management as measured by Cash ratio.

From model 2, one unit increase in cash ratio leads to increase in return on equity by 0.505 units. This implied that the coefficients were significant at 5% significance level. The coefficient of the constant term was -0.218. This is the value that influences financial performance when other variables are not present in the model. This shows that the proportionate change in ROE was negative in the absence of other independent variables.

4.3. Effect of Cash Management on Return on Assets of Deposit Taking SACCOs in Kenya

The study sought to establish the effect of cash management on financial performance as measured by return on assets (ROA) of deposit taking SACCOs in Kenya.

The study sought to determine the effect of cash management on financial performance of deposit taking SACCOs. The coefficient cash management was 0.332 (p-value= 0.001<0.05). This implied that there existed significant positive relationship between return on assets and cash management. A unit increase in cash management as measured by cash ratio would increase the return on assets by 0.332 units, holding other factors in the model constant. Therefore, the null hypothesis that cash management has no statistically significant effect on financial performance of deposit taking SACCOs in Kenya was rejected leading to a conclusion that there is a statistically significant effect of cash management on financial performance of deposit taking SACCOs in Kenya at 5% level of significance.

4.4 Effect of Cash Management on Return on Equity of Deposit Taking SACCOs in Kenya

The study sought to establish the effect of cash management on financial performance as measured by return on equity (ROE) on financial performance of deposit taking SACCOs in Kenya.

Cash management was measured by cash ratio. The coefficient of cash management was 0.505 with a p- value of 0.001<0.05 implying that a unit increase in cash management as measured by cash ratio would result in 0.505 unit increase in ROE, holding other factors in the model constant. Therefore, the null hypothesis that cash management has no statistically significant effect on financial performance of deposit taking SACCOs in Kenya was rejected leading to a conclusion that there is a statistically significant effect of cash management on financial performance of deposit taking SACCOs in Kenya at 5% level of significance. This may be attributed to the role that cash plays in enhancing the liquidity position of a firm. Cash increases the liquidity position of a firm hence reducing liquidity risks associated with cash outs.

5.1 Conclusions

It was concluded that the models used in predicting the effect of cash management on financial performance of deposit taking SACCOs in Kenya were good and reliable. Cash management was positively correlated to financial performance and hence conclusion was made that an increase in the level of cash management by deposit taking SACCOs would lead to a statistically significant increase in their financial performance at 5% significance level.

5.2 Recommendations

- i. The study recommends that firms should increase their cash management levels by putting in place tighter internal control system for cash management so as to increase their financial performance since a higher cash level protects the deposit taking SACCOs against liquidity risk. The study also recommends that SASRA regulator should introduce cash ratios to be deposited within the SACCO regulator. This will enable control of liquidity in deposit taking SACCOs.

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