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Working Capital Management and Financial Performance of selected companies in Kampala

Paluku Kazimoto, PhD
Faculty of Business Administration, Asia Pacific International University

Abstract

This study attempts to establish the level at which selected companies manage their working capital in relation to their financial performance in Kampala. The study employed quantitative approaches with descriptive and correlation designs. The study applied simple random techniques and 63 respondents were selected to respond to questions administered for data collection. The study concluded that the level of working capital management was low as well and the level of financial performance of selected companies was also low. Result reveals that there is a positive and moderate significant relationship between Working Capital Management and financial performance of the selected companies in Uganda.

Keywords: working capital management, financial performance, and selected companies in Kampala.

Introduction

Efficient management of working capital is a fundamental part of the overall corporate strategy to create shareholders' value; Afza and Nazir (2009) indicate that firms try to keep optimal level of working capital that maximizes the value of stakeholders. Companies effectively managing these components can sharply reduce their dependence on outside funding and can use the released cash for further investments or acquisitions and directly affects the profitability which is one of the most important parts of financial decision making in a company (Harris, 2005). Gitman (2009) argues that the objective of working capital management is to minimize the cash conversion cycle; the amount of capital tied up in the firm's current assets. It focuses on controlling account receivables and their collection process, and managing investment in inventory. Working capital management is thus vital for all business survival, sustainability and its direct impact on performance.

Lazaridis and Tryfonidis (2006) while investigating the relationship between working capital management and corporate profitability of listed companies in the Athens Stock Exchange (ASE) indicated that there was a statistical significance between profitability measured through gross operating profits and the cash conversion cycle. Thomas (2011) argued that working capital cycle significantly affects firm profitability negatively, meaning that less profitability of manufacturing firms' longer working capital cycle and that account receivables collection period and account payables payment period each negatively correlates with profitability. Mathuva (2010) indicates firms are capable of gaining sustainable competitive advantage by means of effective and efficient utilization of the resources of the organization through a careful reduction of the cash conversion cycle to its minimum. It is always expected from the profitability of the firms to increase. This study therefore attempts to establish the

extent to which these companies manage their working capital and to what extent this impacts on their financial performance.

The general objective of the study is to establish the relationship between Working Capital Management and financial performance of selected companies in Uganda.

- To analyze the Working Capital Management in the selected companies in Uganda.
- To find out the level of financial performance of selected companies in Uganda.
- To establish the relationship between Working Capital Management and financial performance of the selected companies in Uganda.

Related Literature

Working capital management theory

The concept of working capital management is considered to be a crucial element in determining the financial performance of an organization. Working capital management is a simple and straight forward concept of ensuring the ability of the firm to fund the difference between short-term assets and short-term liabilities (Harris, 2005). The essential part in management of working capital lies in maintaining adequate liquidity in day-to-day operations to ensure smooth functioning of the business. According to Gitman (2009) the objective of working capital management is to minimize the cash conversion cycle; the amount of capital tied up in the firm's current assets. It focuses on controlling account receivables and their collection process, and managing the investment in inventory. Working capital management is vital for all business survival, sustainability and its direct impact on performance.

All businesses in one way or another require working capital, but there is no standard fixed working capital. The actual amount required will depend on many factors such as the age of the company, the type of business activity, credit policy, market and demand conditions, technology and manufacturing policy, operating efficiency, availability of credit from suppliers and price level changes (Pandey, 2007). According to Atrill (2006) working capital represents a net investment in short-term assets. These assets which are continually flowing (circulating) into and out of the business are essential for day-to day operations. He further adds that a decision made on one of the working capital components has an impact on the other components. In order to maximize the performance of a business, the working capital Management should be integrated into the short-term financial decision making process.

Khan and Jain (2007) stressed that working capital management is concerned with the problems that arise in attempting to manage the current assets, the current liabilities and the interrelationship that exists between them. Working Capital Management involves the relationship between a firms's short –term assets and short –term liabilities. The goal of working capital management is to ensure that a firm is able to continue its operations and that it has sufficient ability to satisfy both maturing short-term debt and upcoming operational expenses.

Receivables Management

According to Pandey (2007) a debt is created when a firm sells its products or services for which payment is expected to be collected in the near future. Account receivables (debtors) are customers who have not yet made payment for goods or services that the firm has provided to them. The main objective of account receivables management is to minimize the time-lapse between completion of sales and receipt of payment. In order to significantly increase sales for a business, the customers should be given credit transaction policy. Credit policy and collection policy have to be actively managed because they affect the timing of cash inflows, sales, profits and accounts receivable risks (Gitman, 2009). Any changes in credit and collection policy have a direct impact on the average outstanding accounts receivable balance maintained relative to a business's annual sales.

In establishing credit standards, Horne (2000), suggests a means of categorizing customers for the purpose of approving or refusing credit to them. This will enable the firm to avoid investigating the credit worthiness of customers who fall into the refused category. As a basis for credit extension to those who qualify, he suggests the comparison between the expected cost of credit extension and expected profit to be forgone in the absence of credit. Kelly and McGowen (2010) suggest that credit customers who pay late or don't pay at all only aggravate the problem. Thus, it is important for the financial manager or account receivables manager to establish a good policy that controls the advantages of offering credit with the associated costs.

Stock Management

Inventories as stockpiles of raw materials, supplies, components, work in process, and finished goods that appear at numerous points throughout a firm's production and logistics channels (Ballou, 2004). According to Chase, Jacob and Aquilino (2004) inventory refers to the stock of any item or resource used in an organization. Maintaining optimal inventory levels reduces the cost of possible interruptions or of loss of business due to the scarcity of products, reduces supply costs and protects against price fluctuations. The inventory conversion period has a negative effect on a business's performance. For instance, shortening the inventory conversion period could increase stock out costs of inventory which results in losing sales opportunities and leads to poor performance (Deloof, 2003).

Companies should maintain adequate stock of materials for a continuous supply and maintaining inventories involves tying up of the company's funds and incurrence of storage and handling costs. Pike (2001) adds that stock management is the process that one must follow in order to ensure that the business is keeping the right kind of stock at the appropriate levels, at all times to achieve the level of sales and gross profit budgeted. Atrill (2006) observed that efficient inventory management practices should answer the questions of how much should be ordered and when should it be ordered. These questions relate to the problem of determining the economic order quantity and the problem can be answered by the analysis of the costs of maintaining certain levels of inventory as there are costs involved in holding too much stock and

there are also costs involved in holding too little, hence the need to put in place an effective stock management system to ensure reliable sales forecasts to be used in stock ordering purposes.

Ppayables Management

Accounts payable refers to the credit which has been extended to a business by its suppliers. The decision to make use of supplier credit needs should be carefully assessed in terms of alternative sources of finance, discounts, credit limits, public image with respect to its credit rating, transaction costs, administrative costs, information costs, control costs, the value of the relationship with creditors, buying power of the purchasers, the credit terms, stability and general practices of suppliers, and risk factors. Accounts payable is one of the major sources of unsecured short-term financing (Gitman, 2009). Further, he stated that accounts payable management objective is to pay creditors as slowly as possible without damaging its credit rating. Accounts payable and accruals are the two major spontaneous liability sources of short-term financing for a typical firm. Accounts Payables are the major unsecured short-term financing for businesses. They result from transactions in which merchandise (inventory) is purchased. The suppliers might give credit terms together with allowing discount to the purchasers.

Financial Performance

Company performance is very essential to management as it is an outcome which has been achieved by an individual or a group of individuals in an organization related to its authority and responsibility in achieving the goal legally, not against the law, and conforming to the morale and ethic. Performance is the function of the ability of an organization to gain and manage the resources in several different ways to develop competitive advantage.

Profitability

Profitability ratio is a measure of profit generated from the business and is measured in percentage terms for example percentage of sales, percentage of investments and percentage of assets. High percentage of profitability plays a vital role to bring external finance in the business because creditors, investors and suppliers do not hesitate to invest their money in such a company (Fabozzi and Peterson 2003). There are several measures of profitability which a company can use. One measure of profitability is the net profit margin (NPM). It calculates the percentage of each sale dollar remains after deducting interest, dividend, taxes, expenses and costs. In other words it calculates the percentage of profit a company is earning against its sale. Higher value of return on sale shows the better performance (Gitman, 2009).

Liquidity

Liquidity refers to the degree to which debt obligations coming due can be paid from cash or assets that will be turned into cash. It is usually measured by the current assets to current liabilities (current ratio). It shows the ability to convert an asset to cash quickly and reflects the ability of the firm to manage working capital when kept at normal levels. A firm can use liquid assets to finance its activities and investments when external finance is not available or it is too costly. On the other hand, higher liquidity would allow a firm to deal with unexpected contingencies and to cope with its obligations during periods of low earnings (Skandalis and Liargovas, 2008). The more net working capital a firm has, the less likely that it will default in meeting its current financial obligations (Pandey, 2007).

Sales Volume

According to Churchil and Peter (1994), one method of measuring performance is to conduct sales analysis. This type of analysis consists of gathering, classifying, comparing and studying company sales data. It includes records of what goods or services were sold. They go on to say that there are several ways of carrying out a sales analysis, that is by unit volume and market share. Sales analysis uses the figures to evaluate a firm's current performance. Brookson (1998) however says that the disadvantage of using sales as a measure of performance is because it does not reveal the financial condition of a firm.

Methodology

Research Design and population of the study

The research study employed quantitative approaches with descriptive and correlation designs. Descriptive design was used to describe patterns of behavior, relevant aspects of phenomena and detailed information about each variable. Correlation design was used to determine the relationship between working capital management and financial performance. Data was collected using a self-administered questionnaire through simple random sampling methods. The study was carried out at the three selected companies in Uganda-Kampala. The study population was 71 respondents comprising of employees of the three selected companies who work as top management, accounts, supplies, marketing and operations departments. The focus was on those employees due to their positions that were reliable to get information from the companies' working capital management and performance than employees working in other branches of these companies.

Sample and Sampling Procedure

Out of the **71** respondents, the sample size for the study was **63** respondents. This is based on Krejcie and Morgan's (1970) table for determining sample size. According to this table, for a given population of **75** respondents, a sample size of **63** respondents would to represent a cross section of the population. Simple random sampling technique was used to select the participants.

Research Instrument and data collection

The research instruments for the study were the self-administered questionnaires and interview guide. This is because the respondents in the study are literate and have the ability to read, understand and give their response in writing. The closed ended questions were developed on a four point Likert scale i.e. strongly agree, agree, strongly disagree and disagree. The questionnaire was self-administered to the respondents after getting official permission from the respective authorities.

Data analysis

The researcher did the sorting, coding, data entry, tabulated, and interpreted the findings. For quantitative data, the computer package, SPSS was used to analyze and interpret the data. Frequencies were used to denote the number of responses. Objective 1 and 2 were analyzed using descriptive statistics where frequencies and percentage tables and mean were used. Objective 3 was analyzed using Pearson correlation and multiple regression analysis to test the hypothesis at a significance level of 0.05.

Results and Discussion

Demographic Characteristics of Research Participants

Result indicates that male respondents dominated the study at 57.1% and female were 42.9 %. This implies that the study findings were influenced by male responses. 31 years and above dominated the study 46.0% followed by those of 26-30 with 33.3% and lastly those who had 20-25 with 20.6 %. The results suggest that the age group 31 years and above influenced the findings. Most of the respondents 57.1% had degree, those with masters were represented 30.2%, and lastly12.7% for those who had diploma level of education. It was further indicated that majority of the respondents were positioned in marketing department 28.5%, company managers 20.6%, accounting 19%, supplies department 19% and lastly those who were working as operational staff 12.6% of the respondents. Regarding number of years worked in the company; **39.7%** of respondents had worked for 4-6 years, **28.6%** of respondents had worked for 6 years and above, 19% those who had worked for 1-3 years and 12.7% were those who had worked for less than 1 year.

Level of Working Capital Management in the selected Companies

Table 1: Receivable Management

Items Rated	μ	S. D	Interpretation
The company strictly enforces paying back of debts in time as stipulated in contracts	1.8095	.83968	

The company is strict about credits limits for debts	2.1905	.82025	
The company strictly assesses the ability of customers to pay in time before credit is awarded	2.5238	.77993	
The company succeeds to collect debts within 30 days period	2.3651	1.02078	
The company ensures debtors keep to their payments schedules through regular follow up	2.1905	.93078	
The company debts are always secured through use of collateral and bank guarantees	2.1746	.90767	
Grand Mean	**2.2090**	**0.8831**	**Low**

Sources: Primary Data

Legend 1: *1.00-1.75 (Very low), 1.76-2.51 (Low), 2.56-3.31 (High), 3.32-4.00 (Very High)*

Result from table 1 reveals that, there was a low level of receivable management. Respondents disagreed **(μ = 2.2090; SD = 0.8831)** that there has been high level of receivable management among the selected companies. This means the selected companies do not strictly execute the procedures put in place to manage sales made on credit. On the question that asked if the company succeeds to collect debts within 30 days period, majority **(55.5%)** disagreed that the company succeeds in collecting their debts within 30 days. Thus, many companies compromise on their procedures in order to attract more customers.

Table 2: Stock Management

Stock Management	μ	S. D	Interpretation
Company maintains adequate stock levels to meet customers' demands	2.0159	.75117	
Company monitors stock levels to avoid stock outs	1.8889	.95227	
Company prepares stock budgets	1.9365	1.01398	
Stock takes are often done	1.8413	.88366	
Stock records are accurate	2.0635	.94822	
The company only purchases stock according to the demand	1.9524	.92333	
The company never faces stock outs	2.1429	.83968	
Grand Mean	**1.9773**	**0.9017**	**Low**

Sources: Primary Data

Legend 1: *1.00-1.75 (Very low), 1.76-2.51 (Low), 2.56-3.31 (High), 3.32-4.00 (Very High)*

Result from table 2 reveals that, there was a low level of stock management. Respondents disagreed **(μ = 1.9773; SD = 0.9017)** that there has been high level of stock management among the selected companies. The low level of stock management means that the selected companies under study do not strictly keep their stock levels appropriately. On the question on whether the Company maintains adequate stock levels to meet customers' demands, a majority of the respondents **(87.3%)** disagreed. Majority as well disagreed on the question of whether the company never faces stock outs **(79.4%).**

Table 3: Payable Management

Payable management	μ	S. D	Interpretation
The company pays its suppliers on or before the due dates to avoid penalties	2.2381	1.10299	
The company never delay payments to the extent of hurting its relationship with the supplier	2.1111	1.06424	
The company makes purchases only according to its requirements	2.0794	1.02078	
The company maintains proper records of what it owes suppliers	1.5397	.50243	
The company pays suppliers in time to enjoy invoice discounts	2.0159	1.02378	
Accuracy of invoices are checked before payment is done	1.9841	.87052	
Company gets products at negotiated prices	2.2063	.88279	
Grand Mean	**2.0249**	**0.9239**	**Low**
Total Mean	**2.0704**	**0.9029**	**Low**

Sources: Primary Data

Legend 1: *1.00-1.75 (Very low), 1.76-2.51 (Low), 2.56-3.31 (High), 3.32-4.00 (Very High)*

Result from table 3 reveals that, there was a low level of payable management. Respondents disagreed **(μ = 2.0249; SD = 0.9239)** that there has been high level of payables management among the selected companies. It was noted from the results of the questionnaire that the selected companies do not pay their suppliers in time. On the question on whether the company pays its suppliers on or before the due dates to avoid penalties, a majority of the respondents **(63.4%)** disagreed.

In general, the analysis of data and computation of scores on the construct of working capital affecting the financial performance of selected companies in Uganda yielded **(μ = 2.0704; SD = 0.9029).** Statistically, low standard deviation implies that there is little variation in the research participants' responses, that is; responses on the items in the questionnaire were close.

Table 4: Level of Financial Performance of selected Companies

Items Rated	μ	S.D	Interpretation
Profitability			
Company's profit margins have increased in the last year	1.9048	.9624	
Company has been able to generate profit in the last year	2.0317	1.0155	
Company has been able to meet its annual financial objectives	1.9048	.9107	
Company has been able to raise salaries and wages from profits	1.8095	.9307	
Company pays in time as a result of availability of profits	1.8730	.8888	
Company has funded its business growth from profits	1.9365	.9650	
Pooled Mean	**1.9100**	**0.9455**	**Low**
Liquidity			
The company always has enough cash to meet operational costs as paying employees and utilities	1.6508	.5999	
The company always has enough cash to purchase any equipment considered necessary for the progress of the business	1.6349	.5477	
The company usually goes for short term borrowings to pay suppliers	1.9206	.7251	
Suppliers are paid in time	1.7619	.8369	
Pooled Mean	**1.7420**	**0.6774**	**Low**
Sales Volume			
The company sales has increased over the last year	2.0635	.8006	
The company has opened more outlets in the last year	1.9206	.9384	
The number of customers have increased over the last year	1.8889	.6981	
Company's suppliers have increased over the last year	1.8889	.7429	
Company's number of deliveries have increased	1.8730	.8326	
Company has been able to achieve its sales objectives	2.0159	.8130	
Pooled Mean	**1.9418**	**0.8042**	**Low**
Grand Mean	**1.8646**	**0.8090**	

Sources: Primary Data

Legend 1: *1.00-1.75 (Very low), 1.76-2.51 (Low), 2.56-3.31 (High), 3.32-4.00 (Very High)*

Profitability

Findings in table 4 with regard to profitability, the results indicated that there is low level of profitability of selected companies in Uganda because most of the respondents disagreed **(μ = 1.9100; SD = 0.9455)** with high performance in terms of profitability.

Liquidity

With regard to liquidity, the results Table 8 indicated that there a low level of liquidity among selected companies in Uganda because most of the respondents disagreed **(μ = 1.7420; SD = 0.6774)** with the high financial performance in terms of liquidity. Majority of the respondents (93.7%) disagreed on the question whether the company always has enough cash to meet operational costs as paying employees and utilities.

Sales Volume

Lastly, with regard to sales volume, the results from Table 7 indicated that there a low level of sales volume among selected companies in Uganda because most of the respondents disagreed **(μ = 1.9418; SD = 0.8042)** with the high financial performance in terms of liquidity. In general, the analysis of data and computation of scores on the construct of financial performance of selected companies yielded **(μ = 1.8646; SD = 0.8090)**. Statistically, low standard deviation implies that there is little variation in the research participants' responses that is responses on the items in the questionnaire were close. The low standard deviation suggested that there was less variation in the scores on the construct of financial performance of selected companies in Uganda; in other words, scores on the variables were close to one another.

Relationship between Working Capital Management and financial performance of the selected companies in Uganda

Pearson correlation moment coefficient (r) provides the measure of linear relationship between Working Capital Management and financial performance of the selected companies in Uganda, while coefficient of determination (r^2) indicate the amount variation of financial performance explained by working capital management.

Table 5: Relationship between Working Capital Management and financial performance of the selected companies in Uganda

		Financial Performance
Working Capital Management	Pearson Correlation	0.564**
	Sig. (2-tailed)	0.000
	Coef. of determ.	0.318

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

As indicated in Table 5, there is positive and moderate significant relationship **(r = 0.564, p = 0.000)** between Working Capital Management and financial performance of the selected companies in Uganda. The study findings imply that if the level of working capital is high, then the level of financial performance becomes high.

Further analysis to determine the extent of the relationship between Working Capital Management and financial performance of the selected companies in Uganda based on the coefficient determination **(r^2 = 0.318 x 100)** implies that working capital management contribute **31.8%** to financial performance selected companies in Uganda. The remaining **68.2%** is as a result of other factors that were not considered in this study which still needs to be established. This may mean that there are other factors that contribute much to the financial performance of selected companies in Uganda.

For hypothesis testing, results from Table 5 provide P-value of 0.000 which was less than 0.05 (level of significance). The null hypothesis that stated that there is no significant relationship between working capital management and financial performance of selected companies in Uganda was therefore rejected and the alterative one was accepted. This implies that there was a significant relationship between the working capital management and financial performance of selected companies in Uganda. This meant that if the working capital management were high, then the financial performance of selected companies would yield positive results.

Discussion

Receivable Management

Result from table 1 reveals that the level of receivable management of selected companies is very low and that management was not able to collect debts on time. This implies that many companies in Uganda are liberal in managing receivables and compromise on their procedures in order to attract more customers. Kelly and McGowen (2010) agreed that credit customers who pay late or don't pay at all could aggravate the company debts collection. Thus, it is important for the financial manager or account receivables manager to establish a good policy that controls the advantages of offering credit with the associated costs.

Stock Management

Result from table 2 reveals that, there was a low level of stock management. The low level of stock management means that the selected companies under study do not strictly keep their stock levels appropriately. In line with the study, Horne (2000) noted that a company should maintain adequate stock of materials for a continuous supply and maintaining inventories of the company's funds and incurrence of storage and handling costs. Pike (2001) further added that stock management is the process that one must follow in order to ensure that the business is keeping the right kind of stock at the appropriate levels, at all times to achieve the level of sales and gross profit budgeted.

Payable Management

Result from table 3 reveals that, there was a low level of payable management. It was noted from the results that the selected companies do not pay their suppliers in time. In line with the findings above, one of the reasons why companies are not able to pay their suppliers in time is that too much of their sales are made on credit and the companies do not always succeed to collect these debts. This actually could lead the companies to incur interest and penalties on their borrowings.

Profitability

Findings in table 4 with regard to profitability, results indicated that there is low level of profitability of companies. In line with the findings above, it was noted that working capital management is a major factor that influences performance of companies and not many companies manage their working capital satisfactorily in Uganda. The major reason is that with the stiff competition among the companies, they give a lot of their sales on credit to attract more customers but fail to collect in time. With this, the companies incur so much interest on their borrowings that actually erodes away the gains made on increased sales.

With regard to liquidity, the results Table 8 indicated that there is a low level of liquidity among selected companies. Lastly, with regard to sales volume, the results from Table 7 indicated that they're a low level of sales volume among selected companies in Uganda.

Finally, findings indicate that there is positive and moderate significant relationship between Working Capital Management and financial performance of the selected companies in Uganda. The study findings imply that if the level of working capital is high, then the level of financial performance becomes high. The finding above is in line with the findings of Padachi (2006), who examined the trends in working capital management and its impact on firm's performance. He found a positive significant relationship between working capital management and firms' performance. The results proved that a high investment in inventories and receivables is associated with lower profitability.

Conclusion and Recommendations

Conclusion

The analysis of data and computation of scores on the construct of working capital affecting the financial performance of selected companies in Uganda yielded **(μ = 2.0704; SD = 0.9029).** Statistically, low standard deviation implies that there is little variation in the research participants' responses, that is; responses on the items in the questionnaire were close, and on the construct of financial performance of selected companies yielded **(μ = 1.8646; SD = 0.8090)**. Statistically, low standard deviation implies that there is little variation in the research participants' responses that is responses on the items in the questionnaire were close. The low standard deviation suggested that there was less variation in the scores on the construct of

financial performance of selected companies in Uganda; in other words, scores on the variables were close to one another. Result reveals that there is positive and moderate significant relationship **(r=0.564, p=0.000)** between Working Capital Management and financial performance of the selected selected companies in Uganda. The study findings imply that if the level of working capital is high, then the level of financial performance becomes high.

The study concluded that the level of working capital management in the selected companies was low; the level of financial performance of selected companies was also low. It was further concluded that there is a positive and moderate significant relationship between Working Capital Management and financial performance of the selected companies in Uganda. The study findings imply that if the level of working capital management is high, then the level of financial performance will be high.

Recommendations

Based on the study findings the researcher recommended the following;

Management of selected companies

- Companies have to maintain and strictly enforce policies which promote faster collection of debts but minimize the chances of bad debts and not to lose customers and this will increase firms' financial performance.
- Companies' managers have to look over the proper ways of inventory control techniques like economic order quantity (EOQ) and others. Further, the researcher recommends that companies' marketing, purchasing and operations departments should create strong linkage and communications so as to feed each other in firms' operations and minimize costs.
- The researcher recommends that firms' have to pay all its debt or bills on time so as not to lose their venders in the long run.
- The study recommended that a further research be carried out on other important factors that significantly affect the financial performance of selected companies in Uganda that were not covered under this study: Marketing management practices and financial management in the selected companies in Uganda.

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