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EFFECT OF WORKING CAPITAL MANAGEMENT ON THE PERFORMANCE OF SMALL AND MEDIUM SCALE ENTERPRISES (SMEs) IN KANO STATE, NIGERIA.

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ABSTRACT
Despite the critical role of Small and Medium-scale Enterprises (SMEs) in Nigeria's economy, their high failure rate has been linked to poor working capital management (WCM), with limited empirical evidence on its impact in Kano State. This study examines the effect of WCM (measured by cash, inventory, receivables, and debt management) on SME performance, addressing gaps in regional research and conflicting findings in existing literature. Using a quantitative cross-sectional design, data were collected via questionnaires from 293 SMEs in Kano State, selected through stratified random sampling, and analysed using regression techniques. Results revealed that cash management ($\beta = 0.201$, $p < 0.001$), inventory management ($\beta = 0.485$, $p < 0.001$), and receivables management ($\beta = 0.218$, $p < 0.001$) significantly enhanced SME performance, while debt management showed no significant effect ($\beta = 0.068$, $p = 0.092$). The study concluded that working capital management has significant effect on the performance of SMEs in Kano state. It was recommended that SMEs managers should develop aggressive policies in debt management so as to lessen the possibility of firm's failure due to the inadequate debt management strategies.

Keywords: Working Capital Management**,** SME Performance**,** Cash Management**,** Inventory Management**,** Accounts Receivable Management**,** Debt Management.

1. INTRODUCTION

Performance of small and medium enterprises (SMEs) serves as a vital indicator of national economic growth, primarily due to their significant contributions to employment generation and economic activities (Surya et al., 2021). The efficient operation of SMEs is crucial for economic sustainability, attracting considerable attention from researchers, policymakers, and institutional managers worldwide. High-performing SMEs demonstrate exceptional capacity to innovate and optimize resource management, enabling them to meet daily operational demands while planning for future expansion (Ardito et al., 2021). A key determinant of SME success lies in effective working capital management (WCM), which ensures optimal utilization of financial resources to maintain healthy cash flows and profitability (Chalmers et al., 2020). Strategic WCM implementation allows SMEs to monitor and allocate resources efficiently, fostering continuous improvement in financial performance.

SMEs in Nigeria play a vital role in income generation, poverty reduction, and employment creation (Ufua et al., 2022). While contributing 48.47% to GDP and 7.27% to exports (SMEDAN, 2014), their performance lags behind peers like Indonesia (61% GDP contribution) and Malaysia (38.3% GDP contribution). Nigerian SMEs face challenges including low operational capacity, intense competition, and poor financial management knowledge (Effiom et al., 2022), limiting their economic impact despite their potential. Several initiatives like the Nigerian Vision 20:2020 aimed to boost SME performance and industrialize Nigeria. However, persistent capacity gaps continue to hinder SMEs from driving meaningful economic growth in Nigeria (Joseph et al., 2021). While policy interventions exist, their effectiveness remains constrained by implementation challenges and structural weaknesses in the Nigerian SME sector.

Extensive research has examined working capital management (WCM) components' impact on firm performance using various theoretical frameworks (Zheng et al., 2022; Sensini, 2020; Chalmers et al., 2020), with Rey-Ares et al. (2021) finding collection and inventory conversion periods enhanced profitability in Spain's fish canning industry, aligning with Alvarez et al.'s (2021) positive WCM-performance relationships in Argentine manufacturing and similar findings in Ghana (Braimah et al., 2021) and Europe (Mazanec, 2022). However, contrasting evidence shows negative WCM effects in Italian agriculture (Sensini, 2020), Argentine agro-industry (Sensini& Vazquez, 2021), Chinese firms (Lin & Wang, 2021), and Ghanaian SMEs (Mazanec, 2022), where cash conversion cycles,

collection/payment periods, inventory turnover, and current ratios negatively impacted performance.

Despite the documented yet inconsistent benefits of efficient working capital management on SME performance, the actual perceived effect of working capital components remains unresolved, highlighting the need for further research to validate existing findings. Most of the empirical studies on the effect of WC on SMEs were predominantly originated from foreign contexts, with theoretical foundations largely drawn from Asia (Li et al., 2022; Panda et al., 2021; Yousaf & Bris, 2021), Europe (Mazanec, 2022; Alvarez et al., 2021; Rey-Ares et al., 2021), and some selected African countries (Mabandla & Makoni, 2019), potentially limiting their applicability to diverse economic environments due to regulatory and macroeconomic differences. As Li and Liu (2014) suggested that, the significant variations between developed and developing economies necessitate additional research in developing nations to enrich the existing literature and provide context-specific insights into working capital management's true impact on SME performance.

Therefore, existing research on working capital management (WCM) and SME performance in Nigeria is limited, with most studies focusing on large firms rather than SMEs. This gap highlights the need for context-specific research to understanding the effect of WCM on Nigerian SMEs. Addressing this dearth, this study examined the effect of WCM components (cash, inventory, receivables, and debt management) on SMEs financial performance in Kano State.

2. LITERATURE REVIEW

2.1 Concept of SMEs Performance

SME performance has been conceptualized through various lenses, with scholars commonly associating improved performance with enhanced profitability, operational efficiency, and increased output (Kafetzopoulos, 2022). As the backbone of national economies, SMEs serve as critical drivers of sustainable economic growth by providing efficient financial intermediation, mobilizing domestic savings, allocating resources productively, and facilitating both domestic and international trade (Dobbs & Hamilton, 2016).

Diverse performance metrics include net profit, revenue growth, return on equity (ROE), and share price appreciation (Abdul-Khadir et al., 2020). These indicators fall into two categories: profit measures and investment returns. Financial performance enables comparisons across firms and industries while demonstrating an organization's ability to generate stable earnings through efficient financial management. Hence, financial performance remains a fundamental objective of financial management, particularly in its role of maximizing owner wealth and ensuring business sustainability (Musa, 2024). This makes profitability a crucial metric for evaluating SME success, as it reflects the organization's ability to generate value from its operations.

While startups typically experience initial profitability challenges due to high establishment costs and capital investments, developed SMEs generally demonstrate greater financial resilience, achieving sustainable profit accumulation through operational efficiency, market penetration, and economies of scale (Hokmabadi, 2024). This evolutionary pattern highlights the dynamic nature of SME financial performance across different business lifecycle stages, ranging from start-up to maturity and eventual expansion.Ahmed (2022)identifies four key management practices for ensuring optimal working capital: stock management, creditor management, cash management, and debt management.

2.2 Concept of Working Capital Management

Working capital management (WCM) is fundamental to a firm's operational efficiency and financial stability, akin to how individuals manage daily expenses (Ijuwo, 2024). It reflects a company's ability to balance current assets (cash, inventory, receivables) and liabilities (payables, short-term debt) to meet short-term obligations while sustaining liquidity (Chen &Sensini, 2014; Aktas et al., 2015). Effective WCM optimizes cash flow, reduces borrowing needs, and fuels growth through mergers or acquisitions. However, industry-specific factors such as payment policies, asset cycles, and credit risk cause working capital needs to vary significantly (Talonpoika et al., 2016). Poor WCM can trigger insolvency, asset liquidation, or bankruptcy, underscoring its critical role in financial health (Talonpoika et al., 2016).

WCM directly impacts profitability and competitiveness (Habib, et al., 2024). Excessive working capital ties up resources, increasing costs and reducing returns (Aktas et al., 2015), while insufficient capital risks liquidity crises (Chen et al., 2020). Key practices in WCM include optimizing inventory turnover, accelerating receivables, and deferring payables. Financial managers must align WCM with business goals to enhance market value (Boisjoly et al., 2020). Despite its short-term focus, long-term effect of WCM in sustaining growth during economic instability are equally vital to SMEs survival (Jabbi, 2023). Thus, WCM remains a strategic pedal for SMEs operational resilience and profitability.

2.2.1 Concept of Accounts Receivable Management

Accounts receivable management plays a pivotal role in business operations by overseeing customer credit

obligations, which can expand market share and enhance production efficiency (Bessonova, et al., 2024). While extending credit boosts revenue, its advantages must surpass potential drawbacks like bad debts or payment delays to positively impact financial health (Abbas & Isiaka, 2021). The efficiency of receivables is often gauged by the collection period, with shorter cycles typically indicating improved liquidity and profitability. A well-structured AR system is indispensable for sustaining working capital and mitigating financial risks (Alvarez et al., 2020), though lenient credit terms while potentially increasing sales also heighten working capital demands and default probabilities (Raheman& Nasr, 2007).

2.2.2 Concept of Inventory Management

Inventory management is a critical supply chain function that oversees the flow of goods from manufacturers to warehouses and ultimately to points of sale (Vaka, 2024). It involves maintaining optimal stock levels by tracking inventory movement, ensuring the right products are available in the right quantities at the right locations (Sensina, 2020). Studied have revealed that poor inventory management can lead to stockouts (reducing sales) or overstocking (tying up capital), making Days Sales Inventory (DSI) a key metric for measuring efficiency (Campos et al., 2015; Sensini, 2020). By optimizing inventory levels, businesses can reduce costs, improve cash flow, and maximize profitability through balanced stock management (Ekakitie, et al., 2022). The inventory system serves as the vital link between production output and market demand fulfilment. Hence effective inventory management requires precise record-keeping of all product movements and leverages various techniques to balance supply with demand.

2.2.3 Concept of Cash Management

Cash management, a critical component of working capital management, involves the strategic planning, control, and allocation of cash and its equivalents (including currency, checks, and demand deposits) to achieve profitability, liquidity, and operational efficiency (Xiaohui, 2025). It addresses three key motives for holding cash: transactional needs, precautionary reserves, and speculative opportunities, while ensuring the firm meets its obligations and minimizes idle cash costs. As part of treasury management (Khan, et al., 2021).Cash management encompasses cash balance oversight, short-term investments/borrowing, forecasting, and banking system design, with operating transactions and financial transactions forming its core functions (Demiri, 2021). Efficient cash management optimizes the conversion of receivables and inventory into liquid assets, serving as the foundation for financial stability.

2.2.4 Concept of Account Payable/Debt Management

Effective accounts payable (AP) management is crucial for optimizing cash flow and maintaining strong supplier relationships while minimizing costs (Daniya et al., 2018). It involves tracking and strategically managing short-term obligations to vendors, ensuring timely payments without sacrificing liquidity. Key considerations include evaluating financing alternatives, supplier discounts, credit terms, administrative costs, and the firm's credit reputation (Ismail et al., 2020). While stretching payables can enhance working capital, it must be balanced against ethical, legal, and economic implications, including creditor trust and potential penalties (Bessonova, et al., 2024). The Days Payable Outstanding (DPO) metric reflects payment efficiency, though its impact on profitability remains debated in empirical studies, highlighting the need for context-specific strategies in AP management.

2.3 Theoretical Framework

This study is anchored in three key theories that explain the relationship between working capital management and SME performance: Stakeholder Theory, Agency Theory, and the Cash Conversion Cycle (CCC) model.

Freeman's (1984) Stakeholder Theory emphasizes that organizations must manage relationships with all parties influencing or affected by their operations including suppliers, creditors, and investors who expect value in return for their contributions (Freudenreich, et al., 2020). On the other hand, Agency Theory Aminu & Zainudin, 2015) examines the principal-agent dynamic, where managers (agents) make working capital decisions (most especially in the areas of receivables, payables, inventory) on behalf of owners (principals), often with conflicting interests. Whereas the CCC model (Brennan et al., 2003) prescribes optimizing short-term assets (liquidity) and long-term assets (fixed investments) to enhance financial performance, advocating efficient working capital management as a driver of profitability. Together, these theories underscore the strategic balance required between stakeholder expectations, managerial decisions, and operational efficiency to achieve SME success.

2.4Review of Empirical Studies

The reviewed studies present diverse findings on the working capital management (WCM)-performance nexus, shaped by sectoral, regional, and methodological differences. Sensini (2020) and Sensini& Vazquez (2021) documented negative WCM-profitability relationships in Italian and Argentine SMEs, attributing this to inefficient inventory and payables management. Conversely, Alvarez et al. (2021) and Braimah et al. (2021) reported positive effects in Argentine and Ghanaian firms, emphasizing optimal

receivables/payables strategies. Sector-specific dynamics are evident: Rey-Ares et al. (2021) found convex inventory-profitability links in Spanish fisheries, while Mabandla & Makoni (2019) noted divergent impacts of inventory (positive) and receivables (negative) in South African food firms. Methodological limitations, such as Chasha et al.'s (2022) lack of analytical models or Oladimeji &Aladejebi's (2020) insignificant Nigeria-specific results, highlight contextual nuances. Cross-country studies (e.g., Lin & Wang, 2021; Yousaf & Bris, 2021) reinforce that aggressive WCM policies often harm performance in volatile markets.

Therefore, while most studies (such as Konak & Güner, 2016; Mazanec, 2022) affirm WCM's performance impact, optimal strategies for achieving the best WCM vary accross context. The cash conversion cycle (CCC) emerges as a critical metric for measuring WCM, though its effects range from negative (Panda et al., 2021) to positive (Li et al., 2022). Hence, key gaps identified include overreliance on secondary data (Lamptey, Frimpong & Morrison, 2017) neglecting managerial perspectives. Additionally, limited studies that explored the effect of WCM on SMEs performance in emerging economies were documented, hence the need for additional studies that showcase the extent of WCM application in emerging economies such as Nigeria. Similarly, there exist inconsistent variable operationalization (for instance, profitability measured as ROA, ROE, or GOPM). Studies like Prasad and Lakshmi (2018) offer efficiency-index alternatives but lack generalizability. Hence, this study employed both objective and subjective metrics in examining the effect of WCM on SMEs performance.

3. METHODOLOGY

This study adopted a quantitative research design utilizing a cross-sectional survey approach to examine the relationship between working capital management components (cash management, inventory management, accounts receivable management, and debt management) and SME performance in Kano State, Nigeria. The target population comprised 2,441 registered SMEs documented in the SMEDAN (2017) national survey, with a representative sample of 399 firms selected through stratified random sampling using Taro Yamane's (1967) formula at 5% margin of error. Primary data was collected via structured questionnaires administered to SME owners/managers, employing validated 5-point Likert scale instruments adapted from Afrifa (2016), Oluoch (2014), and Ramiah, et al., (2016) to measure both working capital practices and performance indicators (ROA, sales growth, operational efficiency). Data analysis using SPSS version 26 incorporated descriptive statistics, correlation analysis, and multiple regression, with reliability confirmed through Cronbach's alpha scores exceeding 0.70 and validity established via expert review using Lawshe's (1975) content validity ratio method. The methodology addressed key gaps in existing research by capturing both formal financial metrics and operational indicators relevant to Nigeria's mixed economy, while ensuring sectoral representation through stratified sampling and controlling for firm age, size, and sector in the regression analysis.

4. DATA PRESENTATION AND ANALYSIS

This section presented the result of the regression analysis as thus:

4.1 Data Presentation

The study achieved a 73% response rate with 293 completed questionnaires returned from the 399 distributed to SME owners/managers across Kano State. Preliminary diagnostic tests confirmed the data's suitability for analysis, with Shapiro-Wilk tests ($p > 0.05$) indicating normal distribution of residuals and variance inflation factors (VIF < 5) demonstrating absence of multicollinearity. Descriptive statistics revealed generally high implementation levels of working capital management practices, with mean scores ranging from 2.80 (debt management) to 4.07 (performance) on a 5-point Likert scale.

4.2 Multiple Regression Analysis Result

Table 4.1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.736[a]	.542	.535	.43081

a. Predictors: (Constant), DM, CMD, ARM, IM

Multiple regression analysis was carried out to estimate the effect of working capital management on the financial performance of SMEs. The table above presents the summary of the model in which the item of interest is the adjusted R^2 statistics, which is .535, this suggest that working capital management account for 53.5% of the variation in SMEs financial performance.

Table 4.2: Analysis of Variance – ANOVAa

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	63.211	4	15.803	85.146	.000[b]
	Residual	53.451	288	.186		
	Total	116.662	292			

a. Dependent Variable: PERF

b. Predictors: (Constant), DM, CMD, ARM, IM

Regression analysis explained 53.5% of variance in SME performance (Adjusted $R^2 = 0.535$, $F(4,288) = 85.146$, $p < 0.001$), with three of four working capital components showing significant effects.

Table 2.3: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.164	.264		.622	.534
	CMD	.213	.047	.201	4.569	.000
	IM	.472	.048	.485	9.815	.000
	ARM	.234	.051	.218	4.573	.000
	DM	.090	.053	.068	1.689	.092

a. Dependent Variable: PERF

The regression result shown in table 4.8 reveals that cash management decision (with t-values of 4.57 with a p-value of .000), Inventory management (with the t-value of 9.81 and the p-value of .000), and account receivables management with the t-value of 4.57 and a p-value .000), are significantly related to the performance of the sampled SMEs in Kano.Contrary to expectations, debt management showed no significant effect ($\beta = 0.068$, $t = 1.689$, $p = 0.092$), leading to acceptance of Hypothesis null. This finding contrasts with Badi &Ishengoma's (2021) results but aligns with Kiprotich's (2022) observations about Nigerian SMEs' unique debt dynamics. The insignificant relationship may reflect Kano's distinctive business culture where informal credit systems and relationship-based financing reduce reliance on formal debt instruments.

4.3Discussion of Findings

Cash management demonstrated a strong positive relationship ($\beta = 0.201$, $t = 4.569$, $p < 0.001$),aligning with the finding of the study by Rao, et al., (2024). Inventory management emerged as the strongest predictor ($\beta = 0.485$, $t = 9.815$, $p < 0.001$), confirming the findings of the study by Sah and Furedi-Fulop's (2022) conclusions about inventory control's performance benefits. Accounts receivable management also showed significant positive effects ($\beta = 0.218$, $t = 4.573$, $p < 0.001$), validating Hypothesis 3 and supporting Sah's (2022) arguments about credit management importance.

The robust effects of cash, inventory, and receivables management (all $p < 0.001$) confirm Sensini and Vazquez's (2021) arguments about working capital's operational importance, while the debt management findings highlight contextual variations requiring localized adaptations of working capital theory. These results suggest Nigerian SME managers should prioritize liquidity and inventory optimization over aggressive payables management, contrary to practices effective in more developed markets. The study's explanatory power (53.5% variance explained) substantially exceeds prior Nigerian studies like Oladimeji &Aladejebi (2020), likely due to this research's inclusion of both financial and operational performance metrics.

Notably, the findings reveal a performance paradox where SMEs demonstrate strong working capital implementation (mean scores 3.74-4.05) yet show room for improvement in translating these practices into financial results. This gap may reflect inflationary pressures and supply chain disruptions unique to Nigeria's 2022-2023 economic climate, factors not fully captured in pre-crisis studies. The results provide empirical support for adapting working capital models

to account for emerging market conditions, particularly high inflation environments where traditional liquidity ratios may prove inadequate.

These findings carry important implications for both SME managers and policymakers in Northern Nigeria, suggesting that targeted interventions to improve cash flow monitoring, inventory systems, and receivables collection would yield greater performance benefits than generic working capital advice. Future research should explore the cultural and religious factors underlying Kano SMEs' distinctive debt management approaches, potentially developing context-specific working capital frameworks for Islamic business environments.

5. CONCLUSION AND RECOMMENDATION

This study conclusively demonstrates that effective working capital management significantly enhances SME performance in Kano State, Nigeria, with cash management ($\beta = 0.201$, $p < 0.001$), inventory management ($\beta = 0.485$, $p < 0.001$), and accounts receivable management ($\beta = 0.218$, $p < 0.001$) emerging as critical drivers of financial success. The findings validate the theoretical propositions of Agency Theory and Stakeholder Theory in Nigeria's unique business environment, while revealing the limited impact of debt management practices ($\beta = 0.068$, $p = 0.092$) likely due to cultural financing norms and informal credit systems prevalent in Northern Nigeria. The research provides empirical evidence that working capital optimization explains 53.5% of performance variance among Kano's SMEs, substantially advancing understanding of financial management in emerging market contexts where formal and informal economic systems intersect.

To enhance SME performance, policymakers should prioritize capacity-building programs focusing on cash flow optimization, digital inventory systems, and receivables management, while recognizing the cultural specificity of debt practices in Northern Nigeria. SME managers are advised to implement robust accounting technologies to monitor working capital components, with particular emphasis on reducing cash conversion cycles and maintaining optimal inventory levels. Future research should explore longitudinal impacts across Nigeria's diverse regions, incorporate Islamic financing variables, and examine digital payment systems' moderating effects on working capital efficiency. These recommendations, grounded in robust empirical findings, provide actionable insights for strengthening Nigeria's SME sector as a driver of economic growth and employment generation.

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