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Andeyo, L., Kadima, M. J., & Miroga, J.

The Strategic JOURNAL of Business & Change MANAGEMENT
ISSN: 2312-9492 www.strategicjournals.com
Vol. 9, Iss. 1, pp 1030 – 1039. March 28, 2022. www.strategicjournals.com, ©Strategic Journals

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[1] Andeyo, L., [2] Kadima, M. J., & [3] Miroga, J.

[1] Master Student: Jomo Kenyatta University of Agriculture and Technology [JKUAT], Kenya
[2] Lecturer, Jomo Kenyatta University of Agriculture and Technology [JKUAT], Kenya
[3] Doctor, Lecturer, Jomo Kenyatta University of Agriculture and Technology [JKUAT], Kenya

Accepted: March 17, 2022

ABSTRACT

Credit management is one of the most essential activities in a company and cannot be neglected by any entity involved in the supply of credit lines no matter the nature of its business. Problems that affect SACCOs are several and credit management is a challenge on Sacco's cash flows; hence, affecting smooth running of businesses. Whenever businesses extend credit, the assumption is always that the buyers will pay promptly. This has however made SACCOs unable to maintain their operations due to the competitive nature of the industry and hence some of the SACCOs have been forced to close shop or downsize. The objective of the study was to examine the influence of Credit Terms on Financial Performance of SACCOs in Kakamega County; Kenya. The study employed descriptive research design. The target population of the study included credit managers of the SACCOs. Census survey technique was applied on all the SACCOs. Structured questionnaires were used as the instruments for data collection. Data was analyzed using descriptive statistics and inferential statistics. This was aided by statistical package for social sciences (SPSS). The study found that Credit Term Practices positively influenced financial performance of SACCOS. The study strongly recommended for the embracing of Credit Terms Practices since employing such practices credit management practices improves on financial performance of SACCOs. The study recommended for further studies to be done in other areas of different financial institutions and use other analytical methods.

Key words: *Credit Terms, Credit Management Practices, Financial Performance.*

CITATION: Andeyo, L., Kadima, M. J., & Miroga, J. (2022). Influence of credit terms on financial performance of SACCOs in Kakamega County; Kenya. *The Strategic Journal of Business & Change Management,* 9 (1), 1030 – 1039.

INTRODUCTION

Credit management is one of the most essential activities in any company and cannot be neglected by any entity involved in the supply of credit lines no matter the nature of its business. There has been an increasing attention towards small and medium enterprises (SACCOs) from scholars and practitioners globally in the recent past due to their significant contribution to economies in both developing and developed economies (Asiedu & Freeman, 2017). They are a backbone of many economies.

Basing on global perspective Europe for instance, SACCOs accounted for almost 85% of net new jobs by 2016 (Uwonda, Okello, & Okello, 2015). This is also true in the United States where in 2018, the SACCOs accounted for almost half the number of employees in the economy. According to Caruso (2015), 51.9 percent of all employees were employed by large businesses while the rest were divided between very small enterprises, small enterprises and medium enterprises. Thus, about 56.1 million people were employed by the SACCOs in the US by 2018 census data. This is more than double the number that were employed by the SACCOs in US by 2014 according to Kozlow (2016).

Currently, SACCOs in US contribute to over half of non-farm GDP. Other than Europe and US, SACCOs also play an important role in Asia especially in creating employment for the masses and as a source of economic growth. SACCOs are also a source of foreign currencies in Asian countries. For instance in Indonesia, SACCOs are important for creating employment, generating foreign currencies via exports to other countries in Africa, America, and Europe, as well as their ability to grow into larger enterprises through internationalization (Tambunan, 2019).

In India, SACCOs create the highest employment to the masses through industries accounting for the highest employment growth and share of industrial production and exports (Kumar, 2018). Nowhere else are SACCOS as important as they are in Africa. SACCOs are the biggest job creators in all African economies and an engine of national economic growth. They are also touted as the seeds of big businesses playing the role of suppliers of large enterprises in Africa. However, small businesses are not only suppliers but also consumers of products (Abor & Quartey, 2016). In the national economies in Basing on Regional perspective in Africa SACCOs account for half of the GDP; are more productive than large companies, innovate more, have more impact on social and cultural issues, and play a major part in the future of Africa's economic growth (Uwonda et al., 2015). SACCOs play a significant role in East Africa through alleviation of poverty and participation in the global economy through import-export trade. This has helped develop the national economies.Locally SACCOs account for about 90% of the private sector in Kenya. They are also a major source of employment and wealth creation to the masses especially the women and youth and unskilled or low-skilled workers. They are also a major contributor to tax revenues and are suppliers to larger corporations in terms of supply of goods and services (Ernst & Young, 2015).

Credit management is the policy formulated to regulate the issue and collection of revenue; it is the process by which customer payments are controlled and collected (Kagoyire& Shukla, 2016). It is a necessary function, and any business firm offering credit regardless of the nature of its activities cannot overlook it. Myers and Brealey (2016) described credit management as methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. It is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. Nelson (2017) views credit management as simply the means by which an entity manages its credit sales. It is a prerequisite for any entity dealing with credit transactions since it is impossible to have a zero credit or default risk. The higher the amount of accounts receivables and their age, the higher the finance costs incurred to maintain them. If these receivables are not collectible on time and urgent

The Strategic Journal of Business & Change Management. **ISSN** 2312-9492 (Online) 2414-8970 (Print). www.strategicjournals.com

cash needs arise, a firm may result to borrowing and the opportunity cost is the interest expense paid.

Credit management starts with the sale and does not stop until the full and final payment has been received. It is as important as part of the deal as closing the sale. In fact, a sale is technically not a sale until the money has been collected. It follows that principles of goods lending shall be concerned with ensuring, so far as possible that the borrower will be able to make scheduled payments with interest in full and within the required time period otherwise, the profit from an interest earned is reduced or even wiped out by the bad debt when the customer eventually defaults. Credit management is concerned primarily with managing debtors and financing debts. The objectives of credit management can be stated as safe guarding the company's investments in debtors and optimizing operational cash flows. Policies and procedures must be applied for granting credit to customers, collecting payment and limiting the risk of non-payments.

Credit management is at the center of a business entity for both short and long-term survival. Credit management both the short term and long terms financial aims (Uwonda et. al, 2015). It brings together efforts concerned with payment for goods or services consumed collection of cash from clients who have consumed products or services on credit and general liquidity management (Aminu, 2018). 3 According to Muller (2017), SACCOs must understand credit management if they intend to manage their cash flows. He noted that credit management helps SACCOs to project their cash flow requirements. This helps them optimize their revenues and expenditure timing and amounts. Further, Yaqub & Husain (2016) noted that in order for small businesses to grow, they must address factors that lead to their failure such as cash flow problems. This can be done through better credit management practices.

There are numerous objectives of credit management. According to Aminu (2018) credit management seeks to accelerate cash inflows, delay cash outflows, invest excess cash to earn a return, borrow cash at the best rates available, and maintain an optimal cash level. With better credit and cash flow management practices, a business can hold the right amount of cash and give the business an opportunity to make and receive payments in time. The objective of credit management is to ensure that a business identifies its needs in good time in order to avoid cash flow crisis (Horner, 2015).

Statement of the Problem

Statistically millions of money is lost on SACCOs through avoidable mistakes such as those of poor credit management (Uwonda et. al, 2015). Problems that affect SACCOs are several, for instance Abor and Quartey (2016) indicated that credit management is a challenge on SACCOs cash flows hence affecting smooth running of businesses. Whenever businesses extend credit, the assumption is always that the buyers will pay promptly (Muller, 2017). Furthermore Aminu (2018) noted that most SACCOs handle credit. This however, has made SACCOs unable to maintain the operations due to the competitive nature of the industry and hence some of the SACCOs have been forced to close shop or downsize (Netherlands-African Business Council, 2018). Thus, their survival rate has tended to worsen (Gichuru, 2015) and credit terms may be one of the causes of such low survival rates of these firms. Loveline, Uchenna, & Karubi (2018) assessed the challenges facing women SACCOs and noted that credit terms issue was a major challenge. From the study, the results showed that small businesses were severely hurt by the inability of some of their trade creditors to pay up their debts on time thus affected their working capital. In Kenya, studies on credit management have majorly focused on the management of credit facilities provided by financial institutions (Nduta, 2015;Chick, 2018; Muturi & Rotich, 2016) with Juma, Otuya & Kibati (2018) focusing on deposit taking SACCOs. Studies conducted on SACCOs in Kenya (Njiru, 2018; Oteyo, 2018) failed to pay

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attention to credit terms as a variable under their studies. Furthermore few studies have been conducted on credit terms practices and financial performance of SACCOs in Kakamega County; Kenya. Therefore the present study on the influence of credit terms practices on financial performance of SACCOs in Kakamega County; Kenya, sought to bridge this gap.

Objective of the Study

The objective of this study is to determine the influence of credit terms on financial performance of SACCOs in Kakamega County; Kenya. The study was guided by the following research hypothesis;

- H_{01}: Credit Terms does not significantly influence the financial performance of SACCOs in Kakamega County; Kenya

LITERATURE REVIEW

Theoretical Review

Information Asymmetry Theory

The asymmetric information theory was first explained by Akerlof's in the 1970s. The theory explains that information asymmetry exists when bank lending applications are being assessed (Binks & Ennew, 2017). This theory explains when important information is unknown to every party involved in a transaction (Ekumah & Essel, 2015). Espy (2015) explains the condition whereby the parties that are part of transaction are not aware of all the important facts. The theory explain that when information asymmetry is perceived then financial institutions have two core challenges including moral hazard, in the monitoring of the behaviour of the entrepreneur and adverse selection whereby the firm makes errors as it lends to the wrong people. Transaction cost theory provides an important framework that is used to make decisions that are in regard to the organizations vertical boundaries. Williamson (2016), points out that transaction happens if a service or good is transferred across technologically separable interfaces. When one activity ends another commences. This theory was first explained by Schwartz (1974), whereby according to him, suppliers have an upper hand compared to lenders as they can get information on the credit worthiness of their customers. Suppliers are also able to monitor and ensure full payment of debts by their customers. These advantages give suppliers an advantage in terms of cost compared to traditional lenders. This theory is relevant to this study as SACCOs will be able to effect credit risk controls through proper assessment of clients. However this theory may base on false information provided by a client with motives of accessing credit.

Theory of Business Cycles and Creative Destruction

This theory was proposed by Schumpeter in 1927 as an author about business cycles, entrepreneurship and innovation (Parker, 2017). Schumpeter contended that business cycles are the repetitive changes in the rate at which advancements are brought into the economy, in the force with which business visionaries practice their capacity of beating deterrents to new combinations' (Kuznets, 1940). As per Schumpeter, history contains a couple of surprising scenes in which gatherings of incredibly capable business people present progressive advancements which change existing innovations. Amid these scenes, economies become emphatical and encounter blasts. Be that as it may, the dispersion of these advancements in the long run urge imitators to swarm into the market and contend away the spearheading business visionaries' benefits. Schumpeter contended that such imitators set up the new request as another harmony for the economy. The economy backs off and stagnates, until another arrangement of spearheading business visionaries disturbs the harmony again with another arrangement of progressive developments which renders the past ones old. This accelerates the following blast, and the cycle rehashes itself. Schumpeter recommended that this procedure of entrepreneurial development is in charge of the standard and generally watched changes in monetary movement which he called the typical business cycle. The substitution of old

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advancements absolutely benefits the business visionaries presenting the new ones, to the detriment of officeholders whose creation is attached to more seasoned advances which now get to be out of date. Schumpeter called this procedure 'creative destruction'.

This theory is relevant to this study as lenders watch changes in monetary movement as a result of business cycle. This acts as a good basis for credit standards hence a good credit policy. When business is at recession less credit is given considered to boom seasons. Financial analysts have as of late criticized Schumpeterian advancements and inventive demolition in more formal settings (Aghion & Howitt, 2018). Despite the fact that the creative destruction idea has stood the trial of time, various consequent scholars have censured Schumpeter's record of business cycles. Kuznets (1940) was an early pundit, who brought up that Schumpeter significantly neglects to clarify how unequal entrepreneurial capacities convert into developments through time which offers ascend to blasts and retreats.

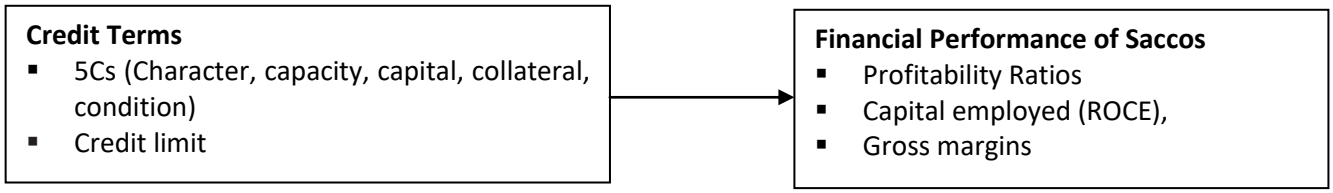
Default Risk Theory

This theory was developed by Hogman, (1960). According to this theory, higher interest rates raise default risk which in turn leads to lending losses. Therefore to avoid this unrestricted and rational lenders prefer to set loan interest rates below market clearing levels and then ration credit. This thesis rests on the nature of credit supply under risky and competitive market conditions that face groups such as SACCOs. Credit rationing is generally defined as a situation where the demand for loans exceeds the supply of loans at the loan interest rate determined by banks. In other words, although there is excess demand for credit at a given interest rate, banks do not respond to it by increasing loan interest rates to the market clearing level where demand becomes equal to supply. Therefore, the excess demand is rationed by nonprice criteria (Stigligz & Weiss, 2016). As banks intermediate between the demanders and the suppliers of funds, they incur costs because deposits and loans are not synchronized. Banks thus charge prices for intermediation services offered under uncertainty, and set interest rate levels for deposits and loans (Kasekende & Pondo, 2015). The spread between the gross costs of borrowing and the net return on lending define the intermediary costs. The latter includes information costs, transaction costs and the operational costs. If borrowers and lenders costs vary unrelated to intermediary costs, then the interest rate spread varies with transaction costs of financial intermediaries. Pure spread is influenced by the degree of bank risk management, market structure in which the bank operates size of the bank transactions and the interest rate variability (Ho & Suander, 2017). The actual spread which includes imperfections in the market is influenced by macroeconomic variables, monetary policy and fiscal policy activities and risk factors. This theory is relevant to the study as credit terms were provided on basis of default measures of a client hence easy to control. This theory can be criticized on the basis that other business factors can lead to defaults and not only the interest rate.

Credit Risk Theory

A borrower may not be able to pay back the loan; this may lead to the lender losing the interest tied to the loan or the entire principal. The lending firm has to assess the borrower's ability to repay the loan. An asset of models represents a development of this category where the loss conditional on default is exogenously accurate. The default can occur throughout all the life of a corporate bond and not only in maturity (Kipngetich & Muturi, 2015). This theory is relevant to the study in the sense that it will help SACCOs to understand members profile and as a result be able to extend a loan to credit worthy individuals who are not likely to default hence securing their credit portfolio thus leading to a sound financial system.

Conceptual Framework



Independent Variable **Dependent Variable**

Figure 1: Conceptual Framework

Review of study variables: Credit Terms and Financial Performance of SACCOs

A Credit term is a contractual stipulation under which a firm grants credit to customers (Wamasembe, 2016), furthermore these terms give the credit period and the credit limit. The firm should make terms more attractive to act as an incentive to clients without incurring unnecessary high levels of bad debts and increasing organizations risk. Credit terms normally stipulate the credit period, interest rate, method of calculating interest and frequency of loan installments. Discounts are offered to induce clients to pay up within the stipulated period or before the end of the credit period.

Sindani (2018) in her study on Effectiveness of Credit Management System on SACCOs Performance: Empirical Evidence from SACCOs Sector in Kenya found out that Credit terms formulated by the finance institutions do affect SACCOs performance; the involvement of credit officers and customers in formulating credit terms affects SACCOs performance. Interest rates charged had a negative effect on the performance of the SACCOs, the higher the interest rates the lower the SACCOs performance. Another study on credit terms by coffee cooperatives stated that none of the cooperative societies used quantitative methods to evaluate credit worthiness of their members instead they used qualitative methods only like the 6Cs technique that is character, capacity, condition collateral, capital and control to the Effects of Credit management on the financial performance of deposit taking savings.

Scheers (2016) examined the challenges facing family-owned SACCOs dealing in groceries in South Africa to understand the extent to which the business owners or managers felt that a number of selected problems affected the success of their businesses. One of the significant findings was that credit terms set affected business success. The results also showed that an inadequate credit term was a problem experienced by about a third of the businesses. This is directly reflective of the lack of credit terms within the businesses. Gaitho (2016) carried out a study on credit terms by SACCOs in Nairobi where findings established that many SACCOs used credit terms management practices to reduce risks. She further found out that majority of them depended a lot on the discretion of portfolio managers for better credit terms management standards contrary to set principles and credit risk formulae rather than decisions to some extent limiting efficient financial performance.

METHODOLOGY

Descriptive research survey design was therefore used to determine an association between the conceptualized independent and dependent variables as shown in the study's conceptual model. A population is the subject on which the estimation is being taken. It is a unit of study (Cooper & Schindler, 2016). The objective populace of this examination was 132 SACCOs (SASRA, 2020). The study sought 132 credit managers one per SACCO

due to their close involvement on credit management practices. In this study the examining outline comprised of all the 132 credit managers hence census survey was applied. This was appropriate as it eliminates sampling error and biasness. The study sample size was determined using Census technique since it was manageable for consideration of the whole population. Primary data was collected by means of self-administered questionnaires. The questionnaires had structured questions. These questionnaires were structured and designed in multiple choice formats. Section one introduced the researcher, topic of research and its purpose to the respondent. Data collected from the field was coded, cleaned, tabulated and analyzed using both descriptive and inferential statistics with the aid of specialized Statistical Package for Social Sciences (SPSS).version 24 software. Descriptive statistics such as frequencies and percentages as well as measures of central tendency (means) and dispersion (standard deviation) was used. Data was also organized into graphs and tables for easy reference.

Further, inferential statistics such as regression and correlation analyses was used to determine both the nature and the strength of the relationship between the dependent and independent variables. Correlation analysis is usually used together with regression analysis to measure how well the regression line explains the variation of the dependent variable. The linear and multiple regression plus correlation analyses were based on the association between two (or more) variables. SPSS version 24 is the analysis computer software that was used to compute statistical data.

Study conceptualized Regression Model;

$Y = \beta_0+\beta_1X_1 + \varepsilon$
Y= Financial Performance
β_0 = Constant
X_1= Credit Terms
$\{\beta_1\}$ = Beta coefficients
ε = the error term

FINDINGS AND DISCUSSIONS

83 of credit managers sought completed and returned the questionnaires, 49 of them either failed to complete the questionnaire or failed to return. This translates to a response rate of 62.9 percent. Gall et al. (2007) asserts that, a response rate of over 60% of the target is adequate for a study. Therefore, the response rate of 62.9 percent was considered adequate to generalise findings of this study.

Descriptive Statistics

Descriptive statistics: Credit Managers on Financial Performance

Credit Managers of SACCOs in Kakamega County revealed that, their SACCOs checks customers collateral base before giving credit which has positively enhanced financial performance (mean = 4.9, standard deviation = 0.5) with SACCOs checking customers character before giving credit which has positively enhanced financial performance (mean = 4.8, standard deviation = 0.6) at the same time, SACCOs checking customers credit capacity before giving credit which has positively enhanced financial performance (mean = 4.6, standard deviation = 0.8), SAACOs checking customers capital ability before giving credit which has positively enhanced financial performance (mean = 3.9, standard deviation = 1.0). Respondents further stated that, SACCOs checks customers condition before giving credit which has positively enhanced financial performance (mean = 3.9, standard deviation = 1.0). The average mean was found to be mean of 5.5 and standard deviation of 0.8.

This implies that, although credit had been highly demanded by SACCO customers credit terms were not favorable to them. In most cases customers' collateral, customers character, customers credit capacity and customers capital ability hindered access to credit. This practice positively influenced financial performance. According to Gaitho (2016) credit terms management practices reduce financial risks for SACCOs in Nairobi County. Sindani (2018) noted that credit terms formulated by the finance

institutions do affect financial performance of SACCOs. The involvement of credit officers and customers in formulating credit terms affects was noted to be of value.

Inferential Statistics

Linear influence of Credit Terms on Financial Performance

This tested the direct influence of Credit Terms on Financial Performance of SACCOs.

Pearson Correlation coefficient between financial performance and explanatory variable was found to be significant at both 95% and 99% confidence level and 2-test with correlation coefficient being 0.972. This indicates that a very strong relationship between the financial performance of SACCOs and credit terms.

Regression

(i) $Y = 0.026 + 0.502X_1$

Where; Y = Financial Performance, X_1 = Credit Terms

Study hypothesis one (H_{01}) stated that Credit Terms does not significantly influence Financial Performance of SACCOs in Kakamega County; Kenya. However, regression results indicate that Credit Terms significantly influence Financial Performance of SACCOs in the County Government of Kakamega (β = 0.502 (0.065) at $p<0.01$). Hypothesis one is therefore rejected. The results indicate that that a single improvement in effective Credit Terms will lead to 0.502 unit increase in the Financial Performance of SACCOs in the County Government of Kakamega ; Kenya.

CONCLUSIONS AND RECOMMENDATIONS

Respondents highly rated that their SACCOs checks credit recovery procedures before recovery of items given on credit which has positively enhanced financial performance, with a flexible credit collection policy that has positively enhanced financial performance. Additionally, SACCOs observes court litigation procedures on credit award which has positively enhanced financial performance. Besides, SACCOs are guided by the vision and mission when giving credit to customers which has positively enhanced financial performance, furthermore SACCOs are guided by the constitution on lending policies which has positively enhanced financial performance.

Credit Terms positively influences financial performance of SACCOS. Credit Terms in most cases includes; customer collateral, customer character, customer credit capacity and customer capital ability hindered access to credit have and more so generated a financial discipline.

SACCO clients should learn the need of having a good credit history, good customer character as well as collateral to enable them access credit with ease. This will also enable them manage the credit with ease.

Areas for further research

The current study was not exhaustive on all the aspects that researchers wished to include in addressing the research problem. Given this and other limitations, the researcher suggests the following for further studies. A study investigating the influence of credit management practices should be extended to other counties in Kenya and findings compared. The researcher also suggests more variables (other than the one used in this study) to be considered and included for further research.

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