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EFFECT OF CASH MANAGEMENT PRACTICES ON FINANCIAL PERFORMANCE OF SMALL MEDIUM ENTERPRISES IN RWANDA: CASE STUDY OF SMEs IN KICUKIRO DISTRICT

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Abstract: **Cash management is necessary service mismatches between the timing of payments and the availability of cash may interfere with operations of a firm. Studies have noted that many SMEs have maintained large cash reserves and liquidity positions within their investment portfolios in an effort to partially accommodate unforeseen expenditure. However, inadequate cash management practices among the SMEs has led to slow rate of service delivery. The purpose of this study was to determine the effects of cash management practices on financial performance of SMEs in Kicukiro District. The objectives of the study were; to evaluate the effects of cash planning on financial performance of SMEs in Rwanda. The study adopted a cross-sectional survey research design and in-depth interviews which allowed the collection of primary quantitative data through structured questionnaires. Target populations of 300 finance managers/ accountants of SMEs comprising 164 trading 26 manufacturing, 10 hairstyling, 62 dressmaking, and 38 carpentry enterprises. Stratified random sampling technique was used to obtain a sample of 172 SMEs both primary data and secondary data was used for the study. Primary data was collected using a well-structured questionnaire. The study utilized questionnaires as an instrument for data collection. Data was analyzed for descriptive and inferential statistics using SPSS version 21. Descriptive statistics such as tables, graphs, charts and percentages analysis were used for presentation of data. Also, a linear regression model was used to analyze quantitative data and was developed and tested to explain the relationship between various proxies of cash management practices and financial performance of SMEs in Rwanda. The findings indicated that there were significant correlation coefficients were established between effects of cash management practices on financial performance. Very good and positive linear relationships were established between effects cash management practices on financial performance: Cash planning (r=0.690, p= .023).The results revealed that cash planning was statistically significant in explaining Financial Performance of SMEs in Rwanda. The study concluded that SMEs need to ensure there are adequate cash management controls to ensure all the time there is optimal cash where there are strategies to be in place during minimal cash and surplus cash since either of the side will contribute to liquidity risks to the organization. The study recommends SMEs to strengthen cash collection avenues by encouraging payment in other forms and move from cash payments, with the advent of mobile money and cash payments to banks where this can be audited for proper payment systems.**

Keywords: **Cash management practices, Cash planning, financial performance.**

1. INTRODUCTION

1.1 Background

Cash management is an essential tool which aims at establishing the financial position of the organization. Pandey (2009) notes that it is a set of guidelines established by management to ensure that the organization has optimal cash balance at any time to meet the organization goals, cash recovered should be matched with cash spent on services so that there are no unused cash balances. According to Patel (2010) cash management had a growing importance in the past years and number of factors has brought serious attention to the importance of cash management. Swing in interest rates on both borrowed and invested funds to get business away from basics and into a go-go mind set with the temptation to make big money through stock issues; to the economic malaise of the 1970s when businesses had to scratch harder to make money (Pinches, 2012).

The success of enterprises largely depends on a number of factors including sound cash management practices (Attom, 2014). The essence of cash management is to ensure positive cash flow for smooth business operation (Abioro, 2013). Barrera (2013) documents that the underlying objective of cash management is having enough cash available as and when it is needed, and that sound cash management involves better timing of expenditure decisions, earlier collection and banking of revenue, and more accurate forecasts of cash flows. This helps minimize the cost of any borrowing that is necessary and facilitates investing surplus funds to achieve the best return overall.

In Africa, it has been 15 years since the original Cash Management Handbook was written, and much has changed since then (Raheman & Nasr, 2011). Cash management is now a household term with frequent articles in the media about its growth, innovation, and changes of technology that can be used cash management such as electronic money transfer (EMT). According to (Pandey 2009) cash planning is a technique used to plan and control the use of cash. It involves preparation of forecasts of cash receipts and payments so as to give out an idea of the future financial requirements.

Sound cash management involves better timing of expenditure decisions, earlier collection and banking of revenue, and more accurate forecasts of cash flows. This helps minimize the cost of any borrowing that is necessary and facilitates investing surplus funds to achieve the best return overall (Mungai, 2014). The techniques of cash management and the degree of sophistication in business processes vary from entity to entity and was influenced by an entity size, geographical location and the nature of its operations. This can be exhibited by the fact that small and medium level enterprises with diverse branches located in different regions within a given country or in different countries normally tried to adopt the cash pooling technique in managing its cash since it takes into consideration cross currency variations thus eliminating currency risk exposure (Ondiek *et al*., 2013). Basically, the process of managing cash today has been significantly influenced by the growing developments in the business world over the years (Kesseven, 2016). Lienert (2009) found out that modern cash management has four major objectives, namely; to ensure that adequate cash is available to pay for expenditures when they are due, to borrow only when needed and to minimize government borrowing costs, to maximize returns on idle cash and to manage risks, by investing temporary surpluses productively, against adequate collateral.

The researches done in South Africa proved that cash management practices in SMEs are poor (Abanis *et al.*, 2013). A number of small businesses are being managed without appropriate strategy and with poor skills in cash management. The efficiency of a business in managing cash may influence the growth of business operations. Failure to do so can affect business operations, as sustenance of business operations can come to a halt. Lienert, (2009). proved that out of five, three businesses failed within a short period of time - three years. It shows that in order to be successful in business, entrepreneurs must possess good strategies and ensure that they can achieve their targets. Besides that, according to Gupta, *et al.* (2014), evidences pertaining to SME financing strongly indicate that firms which are unable to generate sufficient operating cash flow (OCF) are more susceptible to bankruptcy.

In yet another East African, Sunday (2011) assessed the cash management practices of 386 Small and Medium Entities (SMEs) in western Uganda. Furthermore, Sunday (2011) found that the cash management practices of Ugandan SMEs were weak and that most of these entities experienced frequent cash shortages due to a failure to prepare cash budgets on a monthly basis. In addition, only a few SMEs had a cash surplus and those that did, did not invest it in interest-bearing accounts.

In Rwanda majority of the SMEs are micro enterprises with fewer than 10 employees, while 70 per cent of them are one-person, own account workers. This means that majority of SME entrepreneurs are operating at the bottom of the economy, with a significant percentage falling among the 53 percent of Rwandans living below the poverty line of USD 1 per day. The latter are largely for subsistence and engage in economically uncompetitive activities both in urban and rural areas (Kamunge, 2014).

Indeed, the failure rate of SMEs in Rwanda is reported to be one of the highest in the world as about 70% to 80% of these entities fail during their first three years of existence (Ngary, Smith, Bruwer & Ukpere, 2014). Although prior research in other countries has partly attributed a high failure rate of SMEs to ineffective cash management practices (Abanis *et al.* 2013), limited research has been conducted in Rwanda to investigate the cash management practices of SMEs in the country. Therefore, there is a gap in research on cash management practices of Rwanda SMEs. Given the importance of SMEs in creating employment opportunities that are desperately needed in Rwanda and bearing in mind the high failure rate of these entities in the country, it is imperative that their cash management practices be investigated.

1.2 Statement of the Problem:

Cash management is necessary because there are mismatches between the timing of payments and the availability of cash. Even if the annual budget is balanced, with realistic revenue and expenditure estimates, in-year budget execution was not smooth, since both the timing and seasonality of cash inflows and of expenditures can result in conditions of temporary cash surpluses or temporary cash shortfalls (Lienert, 2009). Effective cash management ensures the timely provision of cash resources necessary to support the company's operations. With the use of basic cash management tools and techniques, cash becomes a corporate asset that contributes directly to the bottom line. Whether a company is flush with cash or experiencing a shortfall of funds, good cash management is critical to the success of every company

Notwithstanding the importance of cash and the limited access that SMEs in Rwanda experience, anecdotal evidence suggests that these entities do not seem to manage their cash effectively (Biljon, 2015). Specifically, most of these entities do not prepare cash budgets or forecasts, do not conduct bank reconciliations and do not monitor their cash flows on a real-time basis (Bruwer, 2015).

However, studies have noted that cash short age is a chronic challenge to most firms, and yet cash management is very crucial to the survival and growth of micro and small-scale enterprises (Attom, 2014).

Previous studies by Lobel (2013) found out that improper accounts preparation and inadequate cash management procedure were some of the major challenges facing organizations leading to close up of the enterprises. According to Abanis, *et al.* (2013), among the weaknesses that occur in micro enterprises in terms of cash management is that, most owners do not have bank account to record their sales. This problem occurred because they do not have experience in managing enterprise. In Rwanda, an example may be taken referring to one manufacturing company, CHALOM PAINTS that collapsed because of mismanagement and their liabilities were far outweigh their assets (Hagenimana, 2015).

Therefore, proper, and efficient management of cash is imperative towards the growth of small businesses. Usually, the cash flow of a small business could become a problem when the business deals with a number of customers who are difficult to be tracked and when the business sells products due to higher demand compared to the competitors (Enow, 2015). These problems can be avoided if cash flow is managed properly. It is with this regard that the researcher carried the research on the effects of cash management practices on financial performance of SMEs in Rwanda which helped to fill the gap.

1.3 Objectives of the study:

The general objective of this study was to determine the effects of cash management practices on financial performance of SMEs in Rwanda.

1.3.1 Specific objectives:

The specific objective was to evaluate the effects of cash planning on financial performance of SMEs in Rwanda.

2. CONCEPTUAL FRAMEWORK

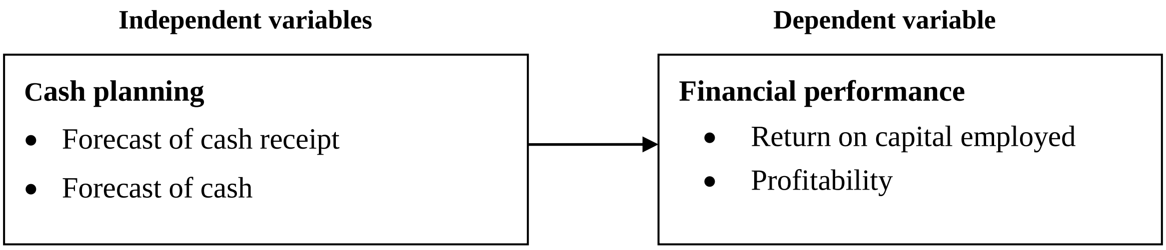

Figure 2.1: Conceptual framework

3. TARGET POPULATION

Target population in statistics is the specific population about which information is desired. According to Ngechu (2014), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. This definition ensures that the population of interest is homogeneous. And by population the researcher means the complete census of the sampling frames. According to Mugenda and Mugenda (2008), target population in statistics is the specific population about which information is desired. The population of the study was 300 SMEs operating in Kicukiro District were subdivided into five mutually exclusive subpopulations or strata herein referred to as business classes as shown in Table 1. These included comprising 164 trading, 26 manufacturing, 10 hairstyling, 62 dressmaking, and 38 carpentry enterprises. The finance manager/Accountant from respective targeted organization were selected to answer the questionnaire

Table 1: Target population

Area of operation	Population
Traders	164
Manufacturing	26
Hairstyling	10
Dress making	62
Carpentry	38
Total	**300**

3.1 Sampling Procedure:

The choice of a sample size is mainly based on the need for accuracy required by the researcher and the degree of variation (Saunders *et al.*, 2009). A total of 172 respondents constituted the sample size for this study. The sample size was statistically calculated using Slovin's formula

n = N/1+ N (e)^2

Where;

n is the sample size,

N is the population size (300)

e is the desired level of precision (0.05)

$$n = \frac{300}{1+300\,(0.05)^2} = 172$$

4. RESEARCH FINDINGS AND DISCUSSION

4.1 Cash planning and financial performance:

The study sought to establish the effects of Cash planning on financial performance of SMEs in Rwanda. Respondent's findings discussed under the following sub headings.

4.1.1 Knowledge on Cash planning:

The study sought to establish as to whether respondents had knowledge on cash planning in the SMEs in Rwanda. The views of the respondents were recorded as shown by the Figure 2 below.

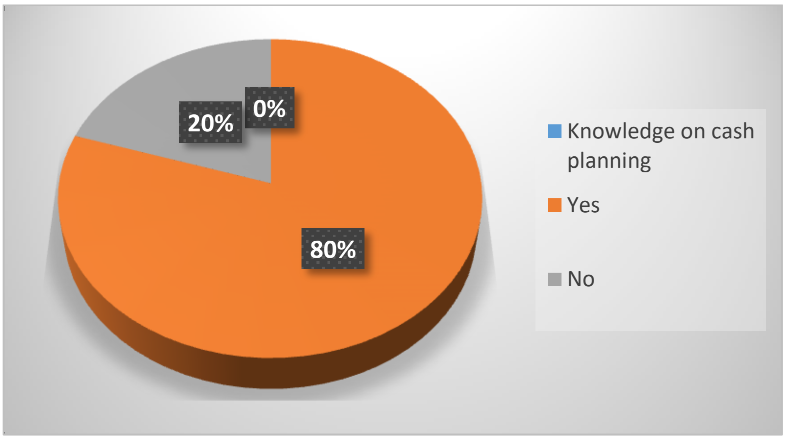

Figure 2: Respondents knowledge on cash planning

From the findings 80% of the respondents indicated that they had knowledge on cash planning whereas 20% indicated that they didn't have knowledge on cash planning.

4.1.2 Cash planning practices on firm's financial performance:

Respondents views on the extent to which aspects of cash planning practices affects the firm's financial performance.

Table 2: Cash planning on financial performance

	N	Mean	Std. Dev
The company keeps records of all cash payment on all daily basis	108	1.48	.504
Budgeting facilities accountability	108	2.10	.410
The company keep records of all cash receipts on all daily basis	108	1.06	.196
SMEs prepare profit and loss account	108	1.52	.505
SMEs prepare balance sheet at the end of accounting period	108	1.56	.000

From the findings indicated in Table 2 Respondents agreed that the company keeps records of all cash payment on all daily basis by a mean of 1.48, the Respondents agreed Budgeting facilities accountability. Due by a mean of 1.06 was obtained when the respondents indicated that the company keeps records of all cash receipts on all daily basis. Same as mean of 1.52 the respondents indicated that SMEs prepare profit and loss account whereas a mean of 1.56 was obtained on the SMEs prepare balance sheet at the end of accounting period.

This study agrees with literature reviewed as states that cash planning is the projection of a company's cash receipts and disbursements over some future period of time (Pandey, 2011). This information helps the financial manager to determine the future cash needs of the firm, plan for the financing of these needs and exercise control over cash and liquidity of the organization (McGuigan, McMoyer, & Kretlow, 2012).

Ross et al., (2008) noted that correlation analysis results give a correlation coefficient which measures the linear association between two variables. Mugenda and Mugenda (2009) explain that correlation analysis tests the strength of association/relationship between the research variables. Table 4.11 shows the correlation between Cash Planning and Financial Performance.

Table 3: Correlation between Cash Planning and Financial Performance

		Cash Planning	Financial Performance
Cash Planning	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	108	
Financial Performance	Pearson Correlation	.557**	1
	Sig. (2-tailed)	.000	
	N	108	108
**. Correlation is significant at the 0.01 level (2-tailed).			

According to above table, the study found that there is significant relationship between Cash Planning and Financial Performance which have correlation index of (r= 0.557). Therefore, the study found that Cash planning has significant relationship to the Financial Performance of SMEs in Rwanda.

5. CONCLUSIONS

Conclusions were arrived at the influence of independent variables (cash Planning, Cash Budget, control, and Cash collection), and dependent variable of financial performance of SMEs in Kicukiro, Rwanda based on the findings of the study. The conclusions were based on the objectives of the study that cash management drivers had a significant influence on financial performance of SMEs in Kicukiro, Rwanda. The results established that cash management drivers were found to significantly and positively influence financial performance. When all the stated variables were tested in the regression model they were found to have a significant relationship between themselves and financial performance of SMEs. Cash control management was the driver which had the highest effect on financial performance of SMEs in Kicukiro, Rwanda by cash collection and cash management. The findings of the study established that SMEs in Kicukiro, Rwanda were operating under a highly competitive environment between them. However, this moderate result revealed that there were all variables which were influencing the financial performance of SMEs in Kicukiro, Rwanda.

5.1 Recommendation:

In view of the data analysis conducted and inferential statistics the researcher would therefore suggest the following:

1. There is need to strengthen cash collection avenues by encouraging payment in other forms and move from cash payments, with the advent of mobile money and cash payments to banks where this can be audited for proper payment systems.
2. There is need to digitize accounts records since with the huge number of persons seeking services, it becomes a big challenge to audit all receipts and to do reconciliation between cash and bank.
3. There is also a need to modernize equipment at these SMEs using these funds/ monies as majority of the operations is funded by the exchequer this is in line with devolution and also in promoting sustainable development goals.
4. Finally, there is need to consider bonus for staff and employees especially when targets have been attained.

5.2 Areas for further research:

The general objective of this study was to investigate the cash management effects of financial performance of SMEs in Rwanda. Specifically, this study investigated the effects of cash planning practices, cash budgeting, cash control and cash collection on financial performance of SMEs in Rwanda. These effects are not exhaustive hence further research can be carried out to unearth other cash management effects of financial performance of SMEs in Rwanda. Secondly, further studies need to be carried out to identify industry-based challenges cash management that these educational industries face and how best these challenges can be addressed to enhance growth and financial performance of the SMEs in Rwanda.

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