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Influence Of Working Capital Management On Financial Distress In Hospitality Industry (A Study Of Four And Five Star Hotels In Nairobi County)

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Abstract: *The objective of this study was to determine influence of working capital management on financial distress in hospitality industry. More specifically the study determined the influence of cash conversion cycle on financial distress in hospitality industry. Theory used in this study was Entropy Theory. Descriptive survey research design was adopted in the study. The targeted population composed of 100 hotels in Nairobi. The study targeted all the financial managers in all the hotels. The study used a simple random sampling method to select 50 hotels whose financial officers served as the study respondents. Data collection was done through use of questionnaires. Questionnaire was tested for validity and reliability. The collected data was analyzed using statistical package for social sciences. Data was analyzed using descriptive statistics which included frequency, percentages, mean and standard deviation and inferential statistics which included regression and correlation analysis and was presented in tables and figures. Findings from the study concluded that cash conversion cycle, inventory level, accounts receivables and current liabilities were insignificant to financial distress management in hospitality industries. Further, it was recommended that firms should adopt debt financing because debt financing is relatively cheaper compared to equity financing hence increase in return on equity.*

Keywords: *Financial Distress, Hospitality, Capital Management, Four and Five star hotels, Nairobi County.*

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I. Introduction

Working capital management is one of critical scopes in financial management because of its influence in liquidation and profitability. There is a possibility of bankruptcy even through profitability in the case of mismanagement of working capital. Working capital deals with current assets and current liability which consists a large part of total assets in firms. Extra investment in current assets leads to lower investment. However, firms with low current assets may encounter difficulties in their business process. Efficient working capital management is in a way which trades off between risk of short term debt default and avoiding from overinvestment in current assets (Raheman & Nasr, 2007). In sum, increasing of receivables and inventories as working capital needs more costly funding and decreases firms return because these assets are low return generating assets. Similarly, decreasing of receivables and inventories as working capital may result in mitigating firm's sale which itself lowers firms value. Both above situation may result in inefficient firm's performance and firm's financial distress (Baños-Caballero *et al.,* 2013). Firms may have optimal working capital leading to their value maximizing (Deloof, 2003).

Working capital management efficiency is vital especially for hospitality firms, where a major part of assets is composed of current assets (Horne & Wachowitz, 2000). It directly affects the profitability and liquidity of firms (Raheman & Nasr, 2007). The profitability liquidity tradeoff is important because if working capital management is not given due considerations then the firms are likely to fail and face bankruptcy (Kargar & Bluementhal, 1994). The significance of working capital management efficiency is irrefutable (Filbeck & Krueger, 2005). Working capital is known as life giving force for any economic unit and its management is considered among the most important function of corporate management. Every organization whether, profit oriented or not, irrespective of size and nature of business, requires necessary amount of working capital. Working capital is the most crucial factor for maintaining liquidity, survival, solvency and profitability of business (Mukhopadhyay, 2004).

The implementation of effective working capital management system is a better way of hotels to improve on their earnings. Since the primary objective of the firm is to maximize on profitability and also to increase on shareholders or owners wealth, it is important to have a balance between liquidity and profitability while carrying out daily operations to ensure the smooth running as well as meeting the company's obligation

(Waithaka, 2012). Effective working capital management is critical in ensuring suitable growth and development of the hotel industry in Kenya in order to boost the organization's profitability.

Working capital management is one of the most important areas while making the liquidity and profitability comparisons among firms (Eljelly, 2004) involving the decision of the amount and composition of current assets and the financing of these assets. The greater the relative proportion of liquid assets, the lesser the risk of running out of cash, all other things being equal. All individual components of working capital including cash, marketable securities, account receivables and inventory management play a vital role in the performance of any firm. The significance of working capital management efficiency is irrefutable (Filbeck, 2005).

The management of working capital plays an important role in maintaining the financial health of the company during the normal course of business. Short-term finance is an essential part of working capital management. Working capital is the only investment a company makes without expecting a defined return. The investment is needed in order to keep the business going rather than to produce something from itself. Because of this, many companies have over-invested in working capital leading to cash flow problems and to a decrease in shareholder value. For many businesses the components of working capital represent the largest items on the balance sheet. Despite this they tend not to be seen as issues demanding strategic consideration or top management attention (Filbeck & Krueger, 2005).

A firm's value cannot be maximized in the long run unless it survives the short run. Firms fail most often because they are unable to meet their working capital needs; consequently, sound working capital management is a requisite for firm survival (Deloof, 2003). The crucial part in working capital financing required in maintaining its liquidity in day-to-day operation is to ensure its smooth running and meet its obligation (Eljelly, 2004). This is not a simple task since managers must ensure that business operation is running in efficient and profitable manner. There are possibilities of mismatch of current asset and current liability during this process. If this happens and firm's manager cannot manage it properly then it will affect firm's growth and profitability. This will further lead to financial distress and finally firms can go bankrupt. This study seeks to establish the influence of working capital management on financial distress in hospitality industry.

Maintaining the working capital at an optimum is the main concern of working capital managers as a firm loses money in the form of interest on the blocked funds in case of holding excess working capital when there are inadequate opportunities. During periods of economic turbulence, the firms with reliable and efficient working capital management practices are able to survive (Reason, 2008). During periods of economic boom also, efficient management of working capital is important as it involves the management of both current assets and current liabilities (Emery, Finnerty & Stowe, 2004). According to Darun (2011), working capital management is not only important in cases of financial distress but can be managed in the most efficient way to increase a firm's profitability and a competitive edge over the others.

II. Hospitality Industry In Kenya

A hotel is an establishment providing for accommodation, food and drinks for travelers and temporary residents, and sometimes other facilities for the transaction of business meetings, conferences, recreation and entertainment. In that sense, hotels are essential to economies and societies (Medlik & Ingram, 2000). The hotel industry plays a vital role to the Kenyan economy in that, the industry supports the tourism sector which currently is the second foreign exchange earner after agriculture. Tourism is accepted as an economic boom and a valuable asset to the national economy. The United Nations World Tourism Organization confirms that between 70% to 75% of international tourists' expenditure goes to hotel services on annual basis (Akpabio, 2007), affirming the strategic importance of the sector. Tourism represents a cheaper alternative for diversification of sectors of the economy, considering the country's competitive advantage in terms of environmental attraction suitable for nature tourism (Akama, 2000), which has consequently contributed to the growth of the hotel industry over the years.

The regulation, rating and licensing of hotels in Kenya is done by the Kenya Hotel and Restaurants Authority (KHRA) established under the Hotels and Restaurants Act, Cap 494 of the Kenyan laws. The hotel industry in Kenya is seasonal in nature and hence the effect of seasonality can be a great challenge when it comes to the management of working capital, basically because of the difficulty faced in attracting large pools of permanent funds through the use of equity capital hence suppliers are likely to provide the short term financing. There should be sufficient planning and efficient management of the working capital to ensure that excess funds generated during the peak season are optimally invested as this will prevent the closure of the business, enhance profitability which will at the same time ensure that the firm's value is maximized. The current demand for standard hotel bed shows that there is a great potential for growth in the hotel industry in Kenya, and working capital management cannot therefore be underestimated.

III. Five star and four star hotels in Nairobi county

The general growth in the Kenyan economy and steady increase in tourism earnings (US$286,000 in 2002 to US$855 million in 2007) led to expansion and new investments in hotels in Kenya. Hospitality organizations are turning to performance measurement and management in order to qualify for the International Organization for Standardization standard certifications, and company of the year awards. General business pressures, the achievement of the coveted five-star rating and membership to international hotel associations have triggered the need for improved performance in the hotel industry (Billy, Odhuno, Kambona & Othuon, 2010).

IV. Statement of the problem

Evaluating the capability of a company to remain a going concern in the foreseeable future is an area of significant interest to investors, creditors, auditors and other stakeholders. The significance of this issue has stimulated a lot of research concerning financial distress. Kenya has experienced its fair share of companies which are in financial distress and almost on the verge of collapsing. These include Uchumi, Kenya Airways and several financial banks which have been on the spot light in the last couple of years. Financial distress is destructive not only for the financial system of the company, but also it impairs its organizational structure, its relationship to external partners and negatively affects the attitudes of the employees towards their work. The question arises on to whether these crises could have been predicted before the actual events. According to Upneja and Dalbor (2001), the reliance on debt financing by the hotel industry in the United States was significant. Due to poor management of working capital, hotels in Kenya, suffer financial distress resulting to change of ownership of various hotels or hotel chains as a measure to prevent the foreclosure from heavy indebtedness. The study research gap is demonstrated by the scarcity of empirical studies on influence of working capital management on financial distress in hospitality industry in Kenya. Empirical studies (Kwansa & Parsa, 1991; Gu & Gao, 2000; Upneja & Dalbor, 2001 and Teruel & Solan, 2005) were inadequate as they concentrated on other industries in developed and emerging economies. None of these studies focused on developing economies such as Kenya. Therefore, this study will seek to establish the influence of working capital management on financial distress in hospitality industry. Class five hotels in Nairobi County.

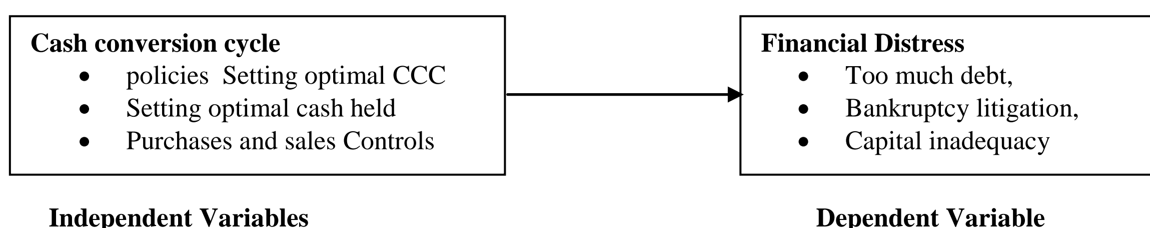
V. Objective Of The Study

The study sought to examine the influence of working capital management on financial distress in hospitality industry, a study of Class four and five star hotels in Nairobi County

VI. Hypothesis Of The Study

Cash conversion cycle have no statistically significant influence on financial distress in hospitality industry in Nairobi Kenya

VII. Conceptual Framework



Independent Variables **Dependent Variable**

VIII. Theroretical Framework

Entropy Theory

According to the Entropy Theory (Balance Sheet Decomposition Measure Theory), one way of identifying firms' financial distress could be a careful look at the changes occurring in their balance sheets (Aziz & Dar, 2006). This theory employs the Univariate Analysis and Multiple Discriminant Analysis (MDA) in examining changes in the structure of balance sheets. Univariate Analysis is the use of accounting based ratios or market indicators for the distress risk assessment (Natalia, 2007). The financial ratios of each company, therefore, are compared once at a time and the distinction of those companies through a single ratio with a cut – off value is used to classify a company as either distressed or non- distressed (Monti & Moriano, 2010). MDA (Multivariate Statistic or Multivariate analysis) is a statistical analysis in which more than one variable are analyzed at the same time (Slotemaker, 2008). The aim of MDA is to eliminate the weakness of univariate analysis. First, single ratios calculated by univariate analysis do not capture time variation of financial ratios. This means that accounting ratios have their predictive ability one at a time, and it is impossible to analyze, for

instance, rates of change in ratios over time. Second, single ratios may give inconsistent results if different ratio classifications are applied for the same firm. Third, many accounting variables are highly correlated, so that the interpretation of a single ratio in isolation may be incorrect. The single ratio is not able to capture multidimensional interrelationships within the firm. Finally, since the probability of failure for a sample is not the same as for the population, specific values of the cutoff points obtained for the sample will not be valid for the population (Natalia, 2007). Therefore, if a firm's financial statements reflect significant changes in the composition of assets and liabilities on its balance sheet it is more likely that it is incapable of maintaining the equilibrium state. If these changes are likely to become uncontrollable in future, one can foresee financial distress in these firms (Aziz & Dar, 2006).

IX. Cash Conversion Cycle

According to Brigham & Houston (2007), Cash conversion cycle represents the length of time that funds are tied up in working capital. The cash conversion cycle (CCC) is taken as a standard measure for working capital management. Cash conversion period reflects the time span between disbursement and collection of cash. It is measured by estimating the inventory conversion period and the receivable conversion period, less the payables conversion period. According to Ross S, Westerfield R. and B. Jordan, (2008), reducing the time cash is tied up in the cash operating cycle improves a business's profitability and market value, hence the significance of efficient cash management practices in improving business performance.

Manoj and Keshar (2007) carried out an empirical study on working capital performance of corporate firms in India by employing the methodology developed by Anand and Gupta (2003) and provided estimates by using the data of non-financial companies with at least three years of publicly available records over the period of 2001 to 2002 to 2003 to 2004 for each company and industry. During the period of study, corporate India had achieved a compound Annual Growth rate of 26.3 % in the net sales and 1.6 % in the three year average cash operating margin. The length of the operating cycle and cash conversion cycle had reduced by 10.2 % and 12.7 % respectively on compounded annual basis.

Lazaridis and Tryfonidis (2006) investigated the relationship that is statistically significant between corporate profitability, the cash conversion cycle and its components. They used a sample of 131 companies listed in the Athens Stock Exchange for the period of 2001-2004. The independent variables used were fixed financial assets, the natural logarithm of sales, financial debt ratio, cash conversion cycle and its components; day's inventory, day's receivable and day's payable. The dependent variable is profitability measured by gross operating profit. The research findings showed negative relationship between cash conversion cycle, financial debt and profitability, while fixed financial assets have a positive coefficient. When the authors replaced cash conversion cycle with accounts receivable and inventory, they found negative relationship with these two variables; the opposite occurred with accounts payable. The authors conclude that companies can create more profit by handling correctly the cash conversion cycle and keeping each different component to an optimum level

Banos-Caballero S, García-Teruel, P and Martínez-Solano. P, 2013) have demonstrated that firms with shorter cash conversion cycle tend to have higher profitability. It has also been argued that firms with a shorter cash conversion cycle are able to maximise profitability due to their ability to internally generate funds, which could reduce their reliance on external finance which often turns to be expensive (Banos-Caballero et al., 2013). According to Luo X, Kanuri.V and Andrews.M (2009), firms with shorter cash conversion cycle free up more funds, which are invested in growth projects, thereby allowing them to rely less on external financial market, resulting in a lower cost of capital and thus improving their profit margins.

X. Financial Distress

Financial distress results from deterioration of a firm's financial performance and can have many causes. Poor management, unwise expansion, intense competition, too much debt, massive litigation, and unfavourable contracts are just a few of the possible causes. (Natalia, 2007). According to Jahur and Quadir (2012), the common causes of financial distress and business failure are often a complicated mix of problems and symptoms. The most significant causes of financial distress in young companies are capital inadequacy where the business did not start with enough capital and has struggled from day one. Capital in any business serves as a mean by which loses may be absorbed. It provides a cushion to withstand abnormal losses not covered in the current earning pattern (Adeyemi, 2012).

Where other companies have undertaken management succession planning for key roles and identified high potential in their company's employee's, usually firms in financial distress do not prepare at all for top management succession (Galloway & Jones, 2006). This could lead to recruiting unbalanced management team which lack essential skills to steer the company ahead. Any wrong investment decision made may plunge the companies to financial distress since some of the decision involves huge cash outlay are irreversible. The importance of innovation to a firms' future has been documented extensively, though the level of risk associated

with innovation has been examined to a small degree (Chao, Lipson & Loutskina, 2012). The probability that innovation will drive a firm to financial distress is high especially where the competitors introduces innovative and competitive products which reduces the attractiveness of the company's products and services (Jahur & Quadir, 2012). Therefore, innovation can either give a firm a competitive edge to its rivals or will see its demise equally.

While most companies rely on their financial performances as the key barometer of financial health, it is important not to ignore managerial and operational signals (Zwaig & Pickett, 2001). Many profitable businesses have found themselves in trouble due to rapid expansion like Uchumi Supermarkets or the introduction of a formidable competitor (Zwaig & Pickett, 2001). In each of these instances, the companies were successful before an operational event or unheeded signal led to financial problem and in some cases the subsequent failure of the company. In other countries, the business that were able to recognize earlier warning signs such as Zellers, Canadians Tire and The Bay have survived by differentiating themselves or changing and improving their business model (Zwaig & Pickett, 2001).

XI. Research Methodology

The study used a descriptive design. A descriptive research is a process of collecting data in order to answer questions concerning the current status of the subjects in the study. The population of the study composed of 100 hotels in Nairobi. The study targeted all the financial managers in all the hotels. The study used Nassiuma (2000) formula (n= $(Nc_v{}^{2)} / (c_v{}^2 + (N\text{-}1)\, e^2)$ to determine the size of sample of the study.

The study primarily used a structured questionnaire constructed on a 5-point Likert Scale to collect data. The questionnaire had close ended statements relating to the study variables. The pilot study findings were analyzed by means of comparisons in order to identify similarities, differences, and patterns in the data. Data collected from the questionnaires was analyzed, summarized, and interpreted accordingly with the aid of descriptive (Frequencies, percentages, means and standard deviations) as well as inferential (Pearson product moment correlation coefficient) statistics. Statistical Package for Social Sciences (SPSS) computer software version 24.0 was used for analysis. The findings were presented in the form of tables and discussions

XII. Findings And Discussions

50 questionnaires were issued to the respondents. All the 50 questionnaires were completely filled up and returned and checked for data completeness and consistency. Questionnaires were correctly filled up and deemed appropriate for data analysis.

Cash Conversion Cycle Descriptive Statistic Results

The study established the views of the respondents regarding cash conversion cycle in hospitality industry by computing the percentages, means and standard deviations of their responses. The findings from the analysis were as presented in Table 4.3.

Table 4. 1: Descriptive Statistics on Cash Conversion Cycle

	SA (%)	A (%)	U (%)	D (%)	SD (%)	Mean	Std. Dev
The hotel's stocks are very fluid that money is not held for long in stock	16	44	14	18	8	3.42	1.197
The high rates of sales enables the hotel to reduce cash conversion cycle period	16	36	10	24	14	3.16	1.346
The company policies ensures that the company does not invest so much in long term asset but on current assets	16	30	12	16	26	2.94	1.476
The company policies do not allow for offering credit services that inhibits the cash conversion cycle	10	50	20	18	2	3.48	.974
The hotel ensures optimal amount of cash is held to meet its obligations	26	38	20	24	0	3.54	1.265
The hotel has been able to meet its current liability obligations in time	18	38	20	24	0	3.50	1.055
The hotel has efficient planning in its purchases and sales	32	52	8	8	0	4.08	.853
Valid N (listwise)	50						

Findings from the table established that 60% of the respondents strongly and/or agreed that hotel's stocks are very fluid that money is not held for long in stock. These findings recorded a mean of 3.42 and a standard deviation of 1.197. A mean of 3.16 and a standard deviation of 1.346 were registered where respondents were not sure whether high rates of sales enable the hotel to reduce cash conversion cycle period. Respondents however disagreed (M=2.94, SD=1.476) that company policies ensures that the company does not invest so much in long term asset but on current assets. It was indicated that 26% of the respondents strongly disagreed while 16% of them disagreed. In addition, 60% of the respondents agreed that the company policies do not allow for offering credit services that inhibits the cash conversion cycle registering a mean of 3.48 and a standard deviation of .974. Additionally, respondents agreed that hotels ensure optimal amount of cash is held to

meet its obligations. 38% of the respondents agreed while 26% of them strongly agreed registering a mean of 3.54 and a standard deviation of 1.265. 38% of the respondents agreed that the hotel has been able to meet its current liability obligations in time while 18% of the strongly agreed. This had a mean of 3.50 and a standard deviation of 1.055. Further the findings demonstrated that 52% and 32% of the respondent agreed and strongly agreed respectively that hotel has efficient planning in its purchases and sales registering a mean of 4.40 and a standard deviation of .870.

Financial Distress Management Descriptive Statistics Results

The researcher sought to examine the responses of the respondents regarding financial distress management by computing the percentages, mean and standard deviation. Findings from the analysis were as shown in table 4.7.

Table 4. 2: Descriptive Statistics on Financial Distress Management

	SA (%)	A (%)	U (%)	D (%)	SD (%)	Mean	Std. Dev
The hotel is well managed with experienced managers	48.0	44.0	2.0	6.0	0	4.34	.798
The hotel has over time been able to grow gradually from a simple restaurant to a full hotel	50.0	30.0	10.0	10.0	0	4.20	.990
The hotel has reduced the amount of debt it owes others putting it in a better financial position	40.0	38.0	4.0	8.0	10.0	3.90	1.298
The hotel has not had bankruptcy issues in courts	44.0	32.0	14.0	10.0	0	4.10	.995
The hotel increased its profits over its period of operations	56.0	36.0	8.0	0	0	4.48	.646
The hotel operations have never been disrupted due to non-availability of financial resources	28.0	44.0	24.0	4.0	0	3.96	.832
The hotel has always managed to finance its budget without any deficits	28.0	32.0	6.0	30.0	4.0	3.50	1.298
Valid N (listwise)	50						

Respondents agreed with the statement that the hotel is well managed with experienced managers where 48% and 44% of the respondents strongly and/or agreed registering a mean of 4.34 and a standard deviation of.798. In addition 50% of the respondents strongly agreed that hotel has over time been able to grow gradually from a simple restaurant to a full hotel while 30% of them agreed. This finding had a mean of 4.20 and a standard deviation of .990. Further, respondents were in agreement that (M=3.90, SD=1.298) hotel has reduced the amount of debt it owes others putting it in a better financial position where 40% of the respondents strongly agreed and 38% of them agreed. However, respondents were in agreement that hotel has not had bankruptcy issues in courts. 76% of the respondents strongly and/or agreed registering a mean of 4.10 and a standard deviation of .995. 56% and 36% of the respondents strongly agreed and agreed respectively that hotel increased its profits over its period of operations recording a standard deviation of 4.48 and a standard deviation of .646. The findings demonstrated that 72% of the respondents agreed that hotel operations have never been disrupted due to non- availability of financial resources. This finding registered a mean of 3.96 and a standard deviation of .832. In addition, 32% and 28% of the respondents agreed and strongly agreed respectively that hotel has always managed to finance its budget without any deficits. It recorded a mean of 3.50 and a standard deviation of 1.298.

Correlation Analysis

Effect of Cash Conversion Cycle on Financial Distress Management

The study examined the relationship between cash conversion and financial distress management in hospitality industry. The findings were presented as shown hereafter.

Table 4. 3: Correlation between Cash Conversion Cycle and Financial Distress Management

		Cash conversion cycle	Financial distress management
Cash conversion cycle	Pearson Correlation	1	.217*
	Sig. (2-tailed)		.020
	N	50	50
Financial distress management	Pearson Correlation	.217*	1
	Sig. (2-tailed)	.020	
	N	50	50
*. Correlation is significant at the 0.05 level (2-tailed).			

It was established that there was a weak positive but significant (r=.217, p=.020) relationship between cash conversion cycle and financial distress management. As such, cash conversion cycle has an impact on financial distress management. These findings were contrary to Lazaridis and Tryfonidis (2006) who showed

negative relationship between cash conversion cycle, financial debt and profitability. Therefore the findings showed that effective cash conversion cycle would lead to mitigation of financial distress in the hotels.

XIII. Conclusions And Recommendations

Based on the summary of findings the study made various conclusions based on the study objective. It was concluded that cash conversion cycle significantly influence financial distress management. Both correlation analysis and regression analysis demonstrated that cash conversion cycle has a significant relationship and/or influence on financial distress management in hospitality industry in Nairobi Kenya. As such, cash conversion cycle has a crucial role in determining the efficiency of financial distress management in hospitality industry. The study recommended that hospitality industries can manage financial distress by handling correctly the cash conversion cycle. The study recommends that the hotels should work on reducing the cycle period which ensure that a lot of cash is not held up in stock. This will ensure effective financial distress management.

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