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EFFECT OF INVENTORY MANAGEMENT PRACTICES ON FINANCIAL PERFORMANCE OF SELECTED SUPERMARKETS WITH NATIONAL NETWORK IN KENYA

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ABSTRACT

Inventory management practices form a core component of working capital management and significantly influence the operational efficiency of retail firms. This study assessed the effect of inventory management practices on the financial performance of selected supermarkets with national network in Kenya. The study was guided by the operating cycle theory, resource-based theory, and agency theory. A descriptive research design was adopted, targeting branch managers of selected supermarkets operating within Nairobi County. Data were collected using structured questionnaires and analyzed using descriptive statistics, correlation analysis, regression analysis, and ANOVA. Financial performance was measured using Return on Assets (ROA) and Return on Equity (ROE). The findings revealed that inventory management practices had a very low effect on the financial performance of supermarkets. The study further established that poor inventory control systems, high inventory holding costs, and inadequate skills among inventory personnel negatively affected supermarket performance. The study recommends continuous training of managers and staff on inventory management practices to enhance operational efficiency and financial sustainability.

Keywords: *Inventory Management Practices, Working Capital Management, Financial Performance, Supermarkets, Kenya*

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INTRODUCTION

Working capital management is critical to a firm's daily operations because it involves investment in current assets and current liabilities that are expected to be liquidated within one year or less (Aburn, 2016). It represents the funds required to finance day-to-day activities that generate revenue. Mathuva (2015) emphasizes that working capital plays a central role in determining a firm's future performance, as it directly influences both profitability and liquidity. Firms that fail to manage working capital efficiently often experience operational disruptions and weakened financial performance.

Efficient working capital management is also recognized as a major internal source of financing (Aktas, 2015). It ensures that a firm continues operating smoothly, meets maturing short-term obligations, and finances emerging operating expenses. Effective working capital management requires proper coordination of its key components cash, inventories, accounts receivable, and accounts payable. These components are interrelated, and their management determines the relationship between short-term assets and short-term liabilities, which is essential for operational sustainability.

Supermarkets in Kenya play a significant role in the country's economic growth by creating employment, enhancing tax revenues, and improving access to consumer goods (Alhassan, 2018). As the economy grows, there is increasing pressure to expand existing supermarkets and establish new ones. However, in the absence of effective working capital management practices, many supermarkets have experienced financial distress, leading to receivership and closure (Afrifa, 2016; Alvarez & Barney, 2017). Poor management of working capital components particularly inventory has been identified as a major contributor to these failures.

Lachman (2016), in a study conducted in Pakistan, found that daily inventory turnover, cash conversion cycle, and net trade cycle significantly affect firm performance. This highlights the importance of establishing effective working capital policies that address individual components such as inventories, current assets, and current liabilities. Globally, supermarkets lose billions of dollars annually due to poor working capital management practices, particularly ineffective inventory control (Viskari, 2013). These losses arise from excessive stock holding, stock-outs, obsolescence, and inefficient cash flow cycles.

The financial crisis experienced by Uchumi Supermarket in 2014 further underscored the importance of maintaining adequate liquidity for daily operations. During economic downturns and periods of credit constraints, supermarkets face heightened liquidity risks. Despite this, many supermarkets are still unable to accurately assess their cash and inventory needs (Goel, 2015). While long-term financing is used to fund capital expenditures, short-term financing is essential for daily operations such as purchasing stock, paying casual workers, and meeting routine expenses. This short-term financing function is the core concern of working capital management (Goel, 2015).

Beyond financial performance, efficient working capital management contributes to overall business management and economic development. A well-functioning financial sector and capital market enhances economic efficiency, growth, and investment (Enqvist et al., 2014). As supermarkets grow, they contribute significantly to national economic development through job creation, tax contributions, and supply chain expansion. Karim et al. (2017) argue that efficient working capital management practices are essential even during periods of economic growth, as they influence all aspects of managing current assets and current liabilities. Etiennot et al. (2016) further contend that working capital management can be strategically applied not only to protect firms from financial distress but also to enhance competitiveness and profitability.

Inventory management is a critical component of working capital management, alongside cash management and accounts receivable management. Nandre (2012) notes that each working capital component has two dimensions time and money. In supermarket operations, time directly translates into money, as delays in inventory turnover increase holding costs and reduce liquidity (Mohammed, 2018). Sagan emphasizes that for money to circulate faster within the working capital cycle, firms must collect receivables promptly and

reduce inventory levels relative to sales. Efficient inventory management therefore minimizes capital tied up in stock and reduces reliance on external financing.

Profitability, defined as the rate of return on a firm's investments, is a key objective of business operations. Profitability creates shareholder value and is achieved through efficient management of working capital, which forms an integral part of corporate strategy (Lins, 2017). Firms that consistently incur losses ultimately face closure, making profitability a critical measure of business success (Enqvist, 2014). In this study, profitability is measured using Return on Assets (ROA), a widely accepted indicator of financial performance (Agha, 2014).

Large inventory holdings and generous trade credit policies may increase sales by reducing stock-out risks and allowing customers access to products before payment (Karim et al., 2017). However, excessive inventory levels can also lead to high holding costs, obsolescence, and reduced returns on investment. Management therefore plays a direct role in balancing current assets and current liabilities to maximize returns (Karaduman, 2010). The cash conversion cycle (CCC), which measures the time between purchasing inventory and collecting cash from sales, is a key indicator of working capital efficiency. A prolonged CCC implies that funds remain tied up in inventory for longer periods, increasing financing needs (Karim, 2017).

In Kenya, the wholesale and retail sector is the fifth-largest contributor to GDP and the third-largest employer in the private sector, contributing approximately 8.4% of GDP (Mbatia & Wanjiku, 2020). Despite this significance, the sector has witnessed the collapse of major supermarket chains such as Nakumatt, Uchumi, Tuskys, and Choppies. These failures have raised concerns regarding the effectiveness of working capital management practices, particularly inventory management, among supermarkets with national networks.

Given the highly competitive nature of the supermarket industry, operational efficiency has become increasingly important (Guy, 2020). Competition is driven by product variety, quality, pricing, and distribution efficiency (Waal, Nierop, & Sloot, 2017). Internal organizational quality including skilled personnel, efficient processes, and accurate performance reporting plays a critical role in sustaining competitiveness. Against this background, effective inventory management practices are essential for improving financial performance and ensuring the sustainability of supermarkets with national networks in Kenya.

LITERATURE REVIEW

Theoretical Review

The study was anchored on the Operating Cycle Theory developed by Richards and Laughlin (1980), which emphasizes the conversion of inventory into sales and subsequently into cash. According to this theory, efficient inventory turnover shortens the operating cycle, improves liquidity, and enhances profitability. Poor inventory turnover, on the other hand, lengthens the cash conversion cycle and negatively affects financial performance.

The Resource-Based Theory further explains that managerial skills, inventory systems, and control mechanisms are valuable organizational resources. In the context of supermarkets, skilled managers and effective inventory management systems contribute to better utilization of inventory and improved financial outcomes.

Empirical Review on Inventory Management Practices

Inventory management practices include determination of economic order quantities, reorder levels, lead time management, inventory holding costs, and personnel skills. The study notes that excessive inventory leads to high holding costs such as storage, security, labor, and risk of obsolescence, while understocking results in frequent emergency orders and loss of sales due to stock-outs.

At the global level, Kavirathna (2022) in the study titled "The Impact of Inventory Management on Financial Performance" examined manufacturing and retail firms and established that effective inventory management measured through inventory turnover, reorder levels, and holding costs—has a positive and significant effect on financial performance, particularly return on assets and return on equity. Similarly, Elsayed and Wahba (2016), in their study "Inventory Management and Firm Performance: The Mediating Role of Functional Effectiveness," found that efficient inventory management improves operational effectiveness, which in turn enhances firm profitability. Their findings emphasized that firms with better demand forecasting accuracy and shorter inventory cycles outperform their competitors financially.

From a regional perspective, Arasa and Achuora (2020) conducted a study titled "Strategic Inventory Management Practices and the Performance of Supermarkets in Nairobi County, Kenya," which revealed that strategic inventory practices such as ABC classification, vendor-managed inventory, and the use of electronic inventory systems significantly improve sales growth and profitability in supermarkets. The study highlighted that technology adoption and structured inventory controls reduce waste and enhance financial outcomes within the retail sector.

Within the Kenyan context, empirical evidence presents mixed results. Mburu (2013), in the study "The Relationship between Inventory Turnover and Financial Performance of Supermarkets in Kenya," found a significant positive relationship between inventory turnover and financial performance, indicating that supermarkets with higher turnover achieved better profitability. Similarly, Mkonu and Gichana (2019), in "Relationship between Inventory Management Policies and Supply Chain Performance of Retail Supermarkets in Nairobi City County, Kenya," established that sound inventory policies improve supply chain performance, which in turn enhances financial outcomes. However, contrary findings were reported by Wanyoike, Onyuma, and Kung'u (2021) in the study "Working Capital Management Practices and Operational Performance of Selected Supermarkets with National Network in Kenya," and by Waweru (2021) in "Working Capital Management and Financial Performance of Selected Supermarkets in Nairobi County, Kenya," where inventory management practices were found to have a weak or insignificant effect on supermarket financial performance. These mixed findings underscore the need for further research on how inventory management interacts with other working capital components to influence supermarket performance.

METHODOLOGY

The study adopted a descriptive research design. The target population comprised 60 supermarket branches located within Nairobi County, drawn from Tuskys, Naivas, Uchumi, and Nakumatt supermarkets. A sample size of 52 branch managers was selected using stratified and random sampling techniques. As shown below:

$$nf = \frac{\mathrm{n}}{1+\frac{n}{N}} = \frac{384}{1+\frac{384}{60}} = 52\ Respondents$$

According to the above formula:

When:

nf = desired sample size when the population is less than 10,000,

n= desired sample when the population is more than 10,000,

N= estimate of the population size = 60

Primary data were collected using structured questionnaires, while secondary data were obtained using data collection sheets. Inventory management practices were measured using indicators such as lead time, reorder levels, economic order quantities, order holding costs, and personnel skills. Financial performance was

measured using Return on Assets (ROA) and Return on Equity (ROE). Data analysis was conducted using SPSS, employing descriptive statistics, correlation, regression, and ANOVA.

RESULTS AND DISCUSSION

Descriptive Results on Inventory Management Practices

The findings revealed that supermarkets experienced challenges in managing inventory effectively. Respondents indicated high inventory holding costs, inadequate inventory management skills, and weak application of inventory control techniques. These challenges resulted in increased operational costs and inefficiencies in stock movement.

Table 1: Descriptive Statistics of Inventory Management Practices

Key 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree

Inventory Management Practices	1 %	2 %	3 %	4 %	5 %	Likert Mean
The supermarket puts in place enough measures to manage lead time for products.	7.7	5.8	3.8	38.5	44.5	4.072
Reorder levels are managed continuously.	0	0	3.8	50.0	46.2	4.42
Overstocking is a common problem that leads to too many unmanageable items.	13.5	30.8	9.6	21.2	25.0	3.13
The supermarket is experiencing increase in costs of holding stocks.	21.2	9.6	1.9	32.7	34.6	3.5
Personnel charged with management of inventory are not skilled.	9.6	19.2	3.8	42.3	25.0	3.54
Overall Mean	10.4	13.46	4.6	37	35.1	3.84

Source: Author (2021)

The findings indicate that most supermarkets have put in place effective measures to manage lead time and reorder levels. A majority of respondents (83%) agreed that supermarkets adequately manage lead time, with a mean score of 4.07, suggesting strong agreement. Similarly, 96.2% of respondents indicated that inventory reorder levels are continually managed, reflected by a high mean of 4.42. These findings suggest that supermarkets recognize the importance of timely stock replenishment and are consistent with previous studies that associate effective lead time and reorder level management with improved long-term performance (Alvarez & Barney, 2017).

Despite effective lead time and reorder level management, challenges related to inventory levels remain evident. Nearly half of the respondents (46.2%) agreed that overstocking is a common problem leading to unmanageable stock items, while 44.3% disagreed, resulting in a moderate mean of 3.13. In addition, a significant proportion of respondents (67.3%) reported increased costs of holding stock, with a mean score of 3.50. These findings indicate that overstocking and high holding costs continue to affect supermarkets and may erode profitability, as similarly observed by Baños-Caballero (2014).

Further, the study established that personnel skills significantly influence inventory management effectiveness. A majority of respondents (67.3%) agreed that staff responsible for inventory management lack adequate skills, yielding a mean of 3.54. This suggests that human resource capacity is a critical challenge in inventory control. The overall mean score of 3.84 for the objective indicates that respondents generally agreed that inventory management practices influence financial performance. This aligns with findings by Aburn (2016) and Aktas (2015), who established that skilled personnel and effective inventory management practices contribute positively to supermarket financial performance.

Correlation Analysis of Inventory Management Practices and Financial Performance

Correlation analysis was conducted to establish the relationship between inventory management practices and financial performance measured using Return on Assets (ROA) and Return on Equity (ROE).

Table 2: Correlation Analysis of Inventory Management Practices and Financial Performance

		Inventory Management Practices	financial Performance
Inventory Mgt. Practices	Pearson Correlation	1	-0.097
	Sig. (2-tailed)		0.496
financial Performance	Pearson Correlation	-0.097	
	Sig. (2-tailed)	0.496	

Correlation significant at 0.01 level (2-tailed)
Source: Author (2021)

The results show a weak relationship between inventory management practices and financial performance. This implies that improvements in inventory management alone were not strongly associated with improved financial performance of supermarkets with national networks.

Regression Analysis of Inventory Management Practices

Regression analysis was conducted to determine the extent to which inventory management practices influence financial performance.

Table 3: Regression Model Summary for Inventory Management Practices

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	-.097	.009	-.010	.67432

Source: Author (2021)

The regression results indicate that inventory management practices explain only a small proportion of variation in financial performance. This confirms that inventory management, when considered independently, does not significantly predict financial performance among supermarkets studied.

ANOVA Results for Inventory Management Practices

Analysis of Variance (ANOVA) was conducted to test the overall significance of the regression model.

Table 4: ANOVA Results for Inventory Management Practices

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.214	1	.214	.470	.496
	Residual	22.735	50	.455		
	Total	22.949	51			

Source: Author (2021)

The ANOVA results show that the regression model was not statistically significant at the 5% level. This indicates that inventory management practices do not have a statistically significant effect on financial performance of supermarkets with national network in Kenya.

CONCLUSION AND RECOMMENDATIONS

The study concludes that inventory management practices have a very low effect on the financial performance of selected supermarkets with national network in Kenya. Supermarkets continue to experience increased inventory holding costs due to unskilled personnel and inadequate inventory management systems.

Ineffective inventory practices lead to capital being tied up in stock, reduced liquidity, and weakened financial performance.

Based on the findings, the study recommends that supermarkets should:

- Continuously train managers and staff on inventory management practices.
- Implement effective inventory control systems to reduce holding costs and improve stock turnover.
- Strengthen inventory planning and monitoring to minimize losses associated with overstocking and understocking.
- Improved inventory management practices are expected to enhance operational efficiency and contribute to better financial performance.

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