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INTRODUCTION
REVIEW OF LITERATURE
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STATEMENT OF THE PROBLEM
OBJECTIVES
HYPOTHESIS (ES)
RESEARCH METHODOLOGY
RESULTS & DISCUSSION
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RECOMMENDATIONS/SUGGESTIONS
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EFFECT OF LIQUIDITY ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KAKAMEGA TOWN, KENYA

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ABSTRACT
Liquidity management is an integral activity in every organization that intends to pay its current obligation. These obligations include operating and financial expenses that are short term. The study specifically, explored the effect of liquidity on profitability of small and medium enterprises in Kakamega Town used as an indicator of performance. To achieve this, a sample of 384 small and medium enterprises was used to provide data. A descriptive survey research design, which provides insights into the research problem by describing the variables of interest and defines, estimate, predict and examine associative relationships was used. Inferential statistics such as simple and multiple linear regression and correlation analysis were used to determine the relationship between the independent and dependent variable. The outcome had some positive correlation between liquidity and performance of small and medium enterprises. The paper concludes that liquidity has a positive effect on the performance of small and medium enterprises in Kakamega town. On the basis of these findings the paper recommends that managers and owners of small and medium enterprises as well as academicians and policy makers should understand liquidity and the effect it has on performance of small and medium enterprises.

KEYWORDS
liquidity, performance of small and medium enterprises, profitability, small and medium enterprises.

INTRODUCTION
Christensen (2004) indicates that global changes in the business environment in the recent years have led to an increasing number of large enterprises demanding innovation. Majority of the scholars have thought this as an attribute to success in financial performance of firms. The reasons for this include; competitive edge in the market, good returns to the shareholders, and last but not least financial performance of firms which has received little research interest (Zain & Hassan 2007). Therefore there is need to identify factors that affect performance of the firms.

In Germany, Baas and Schrooten (2005), Small and Medium Enterprises (SMEs) seem to suffer from limited access to external financial resources. Banks are reluctant to provide credit to this type of enterprises since there is relatively limited publicly available information about SMEs. Legal accounting requirements for these enterprises are low, so that managers of SMEs have only small incentives to invest in detailed information practices. It is often argued that this specific lack of information can be compensated by relationship banking, which enables banks to collect detailed information about an individual firm over time. Nevertheless this information is exclusive. That's why there exists a close linkage between the lending technique of a bank and the interest rate offered to a firm. While relationship lending leads to relatively high interest rates the burden is much lower in the case of financial statement lending.

In Pakistan, Qasim and Ramiz (2014) showed that liquidity management is an integral activity for every organization that intends to pay their current obligations on business which include operating and financial expenses that are short term. The researcher showed that the liquidity ratio affects profitability positively thus recommends managers to be capable of creating worth for their shareholders via reducing the digit of day's accounts receivable and inventories to a rational minimum.

A firm should ensure that it does not suffer from lack-of or excess liquidity to meet its short-term obligations. A study of liquidity is paramount to both the internal and the external analysts because of its close relationship with day-to-day operations of a business (Bhunia, 2012). The Dilemma in liquidity management is to achieve desired trade-off between liquidity and profitability (Nahum and Amarjit, 2013). This study seeks among other things, to investigate the problems of SMEs liquidity management in order to determine its effect on SMEs profitability.

LITERATURE REVIEW
It is necessary for all businesses whether small, medium or large to do liquidity management. This entails collecting cash from customers in time to ensure no difficulty in paying short term debts. Therefore, when a business does not manage its liquidity well, it will have cash shortages and will result in difficulty in paying obligations. In this regard Ali Uyar (2009) opines that, in addition to profitability, liquidity management is vital for ongoing concern. Schilling (1996) suggests optimum liquidity position, which is minimum level of liquidity necessary to support a given level of business activity, it is critical to deploy resources between working capital and capital investment, because the return on investment is usually less than the return on working capital investment. Therefore, deploying resources on working capital as much as to maintain optimum liquidity position is necessary. Then he sets up the relationship between conversion cycle and minimum liquidity required such that if the cycle lengthens, the minimum liquidity required increases, and vice versa.

The management of working capital is one of the most important aspects of Financial Administration, according to Gitman (2003), net working capital is the amount by which a firm's current assets exceed its current liabilities. If the company fails to keep a satisfactory level of working capital, it will probably become insolvent. The current assets of enterprises must be at a level that can cover the liabilities at reasonable margin of safety.

According to Chandra (2001), normally a high liquidity is considered to be a sign of financial strength, however according to some authors as Assaf Neto (2003), a high liquidity can be as undesirable as a low. This would be a consequence of the fact that current assets are usually the less profitable then the fixed assets. It means that the money invested in current assets generates less returns then fixed assets, representing thus an opportunity cost. Besides that, the amounts employed in current assets generate additional costs for maintenance, reducing thus the profitability of the company. However Arnold (2008) points that holding cash also provides some advantages, such as, provides the payment for daily expenses, such as salaries, materials and taxes. Due to the fact that future cash flows are uncertain, holding cash gives a safety margin for eventual downturns. And finally the ownership of cash guarantees the undertaken of highly profitable investments that demands immediate payment. Thus it is an important task for the financial manager to achieve the appropriate balance between the adequate liquidity and a reasonable return for the company.

Some empirical studies have attempted to examine the relationship between liquidity and profitability. In an attempt to measure the impact of liquidity on profitability, Lamberg and Valming (2009) carried out a study using a sample of companies listed on Shochholm Stock Exchange. Their focus was mainly on the impact of active liquidity strategies on company's profitability in and out of financial turbulence. The data was financial ratios which was generated from financial statements. Their findings suggested that the adaptation of liquidity strategies do not have a significant impact on return on assets. Only increased use of liquidity forecasting and short-term financing during financial crisis had a positive impact on return on assets. They also found out that the importance of key ratios monitoring companies' liquidity has not changed between the studied time points. Therefore, they concluded that the adjustment of liquidity practices is beneficial for the companies, even though benefits are not always directly measurable in profitability and, thus, recommended that companies should focus on liquidity and working capital management in an economic downturn.

Raheman and Nasr (2007) selected a sample of 94 Pakistani firms listed on Karachi Stock Exchange for a period of 6 years, found out that there is a strong negative relationship between variables of working capital management and profitability of the firms. The study also shows a significant negative relationship between liquidity and profitability, and that a positive relationship exists between size of the firm and its profitability. Also, there is a significant negative relationship between debt used by the firm and its profitability. Variables used in their analysis included average collection period, inventory turnover in days, average payment period, cash conversion cycle, current ratio, debt ratio, size of the firm and financial assets to total assets ratio.

IMPORTANCE OF THE STUDY

The Government ministries and department collect taxes and spend public funds to meet their recurrent and development projects and program needs. In view of this, the Government benefitted a lot since the SME's were empowered through financial intermediation hence better performance, consequently income to the Government in terms of tax collected from them. Literature review was developed in that the results enabled other researchers to make reference on. A lot of existing literature on role of financial intermediaries and performance of SME's and by extension firms was enlarged and formed a strong foundation for the interested parties. Further, the findings of the study was useful to all those who were involved in the ownership and management of SME's in Kenya. The owners were able to make use of financial intermediaries to boost the performance of their businesses. The managers of financial institutions also benefitted from this information by having clear guidelines on how to embrace financial intermediation to benefit their institutions.

STATEMENT OF THE PROBLEM

The relationship between liquidity and performance of Small and Medium Enterprises (SMEs) has remained a source of disagreement among experts, researchers, professional financial analysts and even managements of profit-oriented businesses. Therefore, views on the actual relative importance of each in business enterprises have continued to differ.

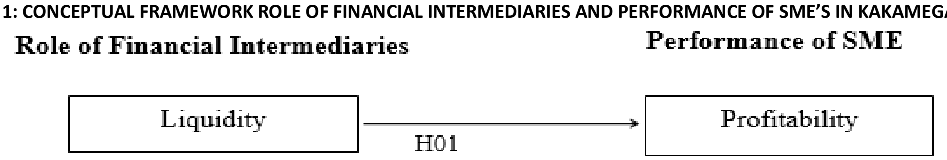
STUDY OBJECTIVE

The objective of the study was to determine the effect of liquidity on the performance of SMEs

STUDY HYPOTHESIS

H_{01} Liquidity had no effect on the performance of SMEs.

FIGURE 1: CONCEPTUAL FRAMEWORK ROLE OF FINANCIAL INTERMEDIARIES AND PERFORMANCE OF SME'S IN KAKAMEGA TOWN



Source: Researcher's own conceptualization 2015

RESEARCH METHODOLOGY

The study used a descriptive survey (describing the characteristics of existing phenomenon) in soliciting information on financial intermediation in Kakamega Town. The population used in this study involved all the Small and Medium Enterprises (SMEs) in Kakamega Town, Kenya which totaled up to 4149 SMEs. A sample of 384 was determined however, to increase the scope of the study, the researcher issued 415 questionnaires and 400 of them were returned which were then used for data analysis. Questionnaires were used for the lead workers whereas the interview guide was used for the managers. The items in the questionnaires were subjected to cronbach alpha coefficient test to determine the reliability of the instrument. It a yielded an r- value of 0.826. This indicated that the instrument is reliable. The data that was collected from the respondents was then descriptively and inferentially analyzed using frequencies, percentages and Pearson's product moment correlation coefficient test.

RESULT AND DISCUSSION

The questionnaire return rate was 96.4% since 400 questionnaires were returned out of 415 that were supplied. The response rate of at least 90% was considered a good rate according to (Saunders et al., 2007).

GENERAL INFORMATION OF THE RESPONDENTS

It was important to have general background information concerning the responses. This information was important to establish whether they were in a better position to respond to the questionnaires or not. The information sought for purposes of having background information included, gender, age bracket of the respondents, level of education and the number of years they have worked as SME's. The following were response recorded.

GENDER

The respondents indicated their gender and the results were recorded in Table 1 below.

TABLE 1: GENDER DISTRIBUTION

	Gender of Respondents		
	Frequency	Percentage	Cumulative Percentage
Male	267	66.8	66.8
Female	133	33.2	100.0
Total	**400**	**100.0**	

Source: Research Data, 2015

According to the results in Table 1 above, majority of the respondents were males (66.8%) while the rest were females (33.3%). It was an indication that more male participated in this study than females. This could be as a result of more male employees than female. Alternatively, women's traditional reproductive roles have to be combined with other activities, like employment leaving little energy and time for the latter (UDEC, 2002), may explain why the number of women who participated in this study is lower. However, the representation of women is enough in the study.

AGE BRACKET OF RESPONDENTS

The results in table 2 show that, between 20 and 30 years old, there were 10.8% of the respondents; between 31 years and 40 years, there were 38%; between 41 years and 50 years, there were 45%; while those who were 51 years old and above were 6.3%. From these results, it implies that majority of the respondents (83%) were in the active age bracket of 31-50 years.

TABLE 2: AGE DISTRIBUTION OF RESPONDENTS

	Age Bracket of Respondents		
Age Bracket	**Frequency**	**Percentage**	**Cumulative Percentage**
20-30 Years	43	10.8	10.8
31-40 years	152	38.0	48.8
41-50 Years	180	45.0	93.8
Over 50 Years	25	6.2	100.0
	400	**100.0**	

Source: Research Data, 2015

Age affects the level of motivation to perform any function in an organization. Majority of respondents were in the age range of between 31 to 50 years old. This age is important in a business setting for instance in the SME's because it is an active age that is quite productive.

EDUCATIONAL LEVEL OF THE RESPONDENTS

The level of education was very important in this study. This information was vital in making decisions on the role of financial intermediaries on the performance of SME's in Kakamega Town. The results were recorded in Table 3 below. The results illustrate that 1% of the respondents had primary education, 22% had secondary education, 20.8% had college education, 13.5% had university education, and 15.8% had post graduate education, while the remaining 27% had professional qualification. From the results, over 95% of the respondents have enough education background to fill and respond to the questionnaires with ease.

TABLE 3: EDUCATIONAL LEVEL OF RESPONDENTS

Level of Education	Frequency	Percent	Cumulative Percentage
Primary	4	1.0	1.0
Secondary	88	22.0	23.0
College	83	20.75	43.8
University	54	13.5	57.3
Postgraduate	63	15.75	73.0
Professional qualification	108	27.0	100.0
Total	**400**	**100.0**	

Source: Research Data, 2015

NUMBER OF YEARS WORKED

This section was also important to the study. It helped establish the years of experience they have in their business. The results were as shown in Table 4 below.

TABLE 4: NUMBER OF YEARS WORKED

Number of Years Worked	Frequency	Percent	Cumulative Percentage
Less than 5	67	16.75	16.8
5-10 years	187	46.75	63.5
Over 10 years	146	36.5	100.0
Total	**400**	**100.0**	

Source: Research Data 2015

From the results, 16.75% of the respondents have worked for less than 5 years, 46.75% have worked between 5 to 10 years while the remaining 36.5% have worked for over ten years. The results indicate that majority of the respondents i.e. 83.25% have worked for at least 5 years. This implies that they are in good position to have important information to the study regarding the performance of their businesses.

DESCRIPTIVE STATISTICS OF LIQUIDITY

Role of financial intermediaries was the independent variable on the conceptual framework shown in Figure 1. The construct under role of financial intermediaries was; liquidity. This variable was analyzed through dimension reduction of factor analysis (i.e. through central limit concept of varimax) and its mean was then computed and further used in the study. The following results demonstrate the outcome of the study.

There were several questions that aimed at establishing from the respondents how liquidity affected the performance of SME's. The respondents were asked to score the questions that were rated on the five (5) point Likert Scale ranging from 1= Strongly Disagree, 2 = Disagree, 3 = Neither Agree nor Disagree, 4 = Agree, and 5 = Strongly Agree. The results were as shown in Table 4.5 below. From the results the question; SME's maintain enough cash cover to pay for their short term debt had a mean of 4.7525 with standard deviation of 0.53099, SME's receive loans from the financial institutions like banks among others which improves their performance had a mean of 4.5625 with standard deviation of 0.63805, SME's receive varieties of credit facilities from banks to improve on their capital base had a mean of 4.5500 with standard deviation of 0.65847, The SME's repay their credit facilities on time and still manage to run their businesses had a mean of 4.5750 with standard deviation of 0.6167.

The mean scores are above 4 and their respective standard deviations are less than 1. SME's maintain enough cash cover to pay for their short term debt had a lower standard deviation than the other items and this implies that it's closer to the mean and actually shows that SMEs have enough cash to pay for their short term debt. However, very few SMEs receive variety of credit facilities from this same institutions and this could be as a result of high interest rates on this loans etc. This is indicated by a higher standard deviation which shows that the responses were spread out. This concurs with Lamberg and Valming (2009) carried out a study using a sample of companies listed on Shochholm Stock Exchange. Their focus was mainly on the impact of active liquidity strategies on company's profitability in and out of financial turbulence. The data was a financial ratio which was generated from financial statements. Their findings suggested that the adaptation of liquidity strategies do not have a significant impact on return on assets. Only increased use of liquidity forecasting and short-term financing during financial crisis had a positive impact on return on assets. They also found out that the importance of key ratios monitoring companies' liquidity has not changed between the studied time points. Therefore, they concluded that the adjustment of liquidity practices is beneficial for the companies, even though benefits are not always directly measurable in profitability and, thus, recommended that companies should focus on liquidity and working capital management in an economic downturn.

TABLE 5: DESCRIPTIVE STATISTICS OF LIQUIDITY

	Descriptive Statistics of Liquidity on Performance	Mean	Standard Deviation
i.	SME's maintain enough cash to cover for their short term debt	4.7525	0.53099
ii.	SME's receive loans from the financial institutions like banks among others which improves their performance	4.5625	0.63805
iii.	SME's receive varieties of credit facilities from banks to improve on their capital base	4.5500	0.65847
iv.	The SME's repay their credit facilities on time and still manage to run their businesses	4.5750	0.61671

Source: Research Data 2015

HYPOTHESIS TEST

TABLE 6: CORRELATION RESULTS OF LIQUIDITY AGAINST PERFORMANCE

Model Summary						
Model		*R*	*R Square*	*Adjusted R Square*	*Std Error of the Estimate*	
1	Predictors: (Constant), Liquidity	0.753[a]	0.567	0.566	0.46958	
Model		*Unstandardized Coefficients*		*Standardized Coefficients*	*T*	*Sig.*
		B	Std. Error	Beta		
1	(Constant) Liquidity	2.030	0.116		17.56	0.000
		0.590	0.026	0.753	22.83	0.000

a. Dependent Variable: SME performance

b. Predictors: (Constant) Liquidity

Source: Research Data 2015

This correlation results in Table 6 above show that liquidity has a positive effect on the performance of SME's. The results indicate that 56.7% of the SME's performance can be explained by liquidity (r^2=0.567) and the relationship followed a simple regression model of the nature $P=\alpha+\beta_1 L+e$, where P is the SME performance, α was the constant intercept of which in our case was 2.030 and beta β_1=0.753, L was liquidity and e was the standard error term.

The correlation results between the mean of liquidity and the mean of SME's performance (P) had a beta term β_1=0.753 at p=0.01. In the hypothesis criteria, we were to reject H01 if $\beta1\neq0$. However, from these results, the value of beta β_1=0.753 and yet $0.753\neq0$. The study therefore rejects the null hypothesis and conclude that liquidity has a statistically significant positive effect on the performance of SME's in Kakamega Town.

CONCLUSION

The study concludes that liquidity has a positive effect on the performance of Small and Medium Enterprises (SME's). The studies reveal that financial markets direct the flow of funds from savers to investors, by bringing buyers and sellers together, therefore affecting the wealth of individuals and how businesses behave, and the entire economy. In so doing, financial markets facilitate economic efficiency, and economic growth. Funds can be transferred by the financial market from savers to borrowers through direct transfers, investment bankers or use of intermediaries.

The study further recommends that Small and medium enterprises should aggressively engage in ensuring their businesses have enough cash cover. The study reveals that there is a statistically significant positive effect between liquidity and performance of SME's.

LIMITATIONS

The research instruments that included questionnaires and interview schedules used for data collection was time consuming and costly. The researcher overcame this by setting time frames within which the interviews were conducted to save time and reduce costs. The respondents lacked trust and thus hide information crucial for the study from the researcher. To overcome this, the researcher assured them that the information was only confidential and would not be released to competitors. In addition, the Small and Medium Enterprises (SME's) subjected their views due to biasness because they were aware that the information generated from the study was useful to them. The researcher overcame this by citing other existing literature information on the area of study. The findings of the study were influenced by the researcher's subjectivity. The researcher addressed this through citing literary sources to support personal views to minimize subjectivity.

SUGGESTIONS FOR FURTHER STUDIES

The following suggestions were made for further research based on the findings of this study. The study was done in Kakamega Town, which is found in Kakamega County. Further research is encouraged to have other counties also covered to check whether the results are still the same. In future a comparison should be done between the financial performance of Small and Medium Enterprises (SMEs) that have not embraced financial intermediation and the ones that have not. This may help in shedding light on whether embracing financial intermediation helps the SMEs to perform better than the other businesses.

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