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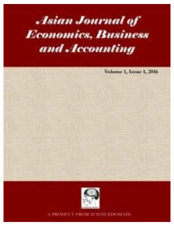
Article · January 2017

DOI: 10.9734/AJEBA/2017/35237



Asian Journal of Economics, Business and Accounting

3(4): 1-8, 2017; Article no.AJEBA.35237
ISSN: 2456-639X

Effect of Working Capital Management Practices on the Performance of Small and Medium Enterprises in Oyo State, Nigeria

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Authors' contributions

This research work was carried out in collaboration between both authors. Author OAA designed the study, performed the statistical analysis and wrote the protocol. Author OAK wrote the first draft of the manuscript, managed the analyses of the study and the literature searches. Both authors read and approved the final manuscript.

Article Information

DOI: 10.9734/AJEBA/2017/35237
Editor(s):
(1) O. Felix Ayadi, Interim Associate Dean and JP Morgan Chase Professor of Finance Jesse H. Jones School of Business, Texas Southern University, TX, USA.
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Reviewers:
(1) Jacob Donkor, Ghana Baptist University College, Ghana.
(2) Hamisi Sama, College of Business Education, Tanzania.
Complete Peer review History: http://www.sciencedomain.org/review-history/20317

Original Research Article

Received 1st July 2017
Accepted 28th July 2017
Published 2nd August 2017

ABSTRACT

This study examined the effect of Working Capital Management (WCM) practices on the performance of Small and Medium Scale Enterprises (SMEs) in Oyo State, Nigeria. The relationship between cash management practices and the performance of SMEs was examined and the impacts of inventory and trade management practices on SMEs' performance were also evaluated.

The study was carried out on 150 SMEs operators who were selected using stratified random sampling method. Primary data were sourced with the aid of questionnaires. Data were analyzed using both descriptive and inferential tools such as Frequency counts, Percentages, Multiple Regression Analysis and Spearman Rank Correlation Coefficient. The result of the study showed positive relationship between SMEs' performance and Cash management practices. Furthermore, inventory management practices had significant effect on SMEs performance as the variables;

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inventory shrinkage ($t = -2.560$, $p<0.05$), inventory investment ($t = 1.922$, $p<0.05$) and inventory turnover ($t = 1.967$, $p<0.05$) affected SME's performance significantly. Also, trade credit management practices impacted significantly on the performance of SMEs as the predictors; credit policy ($t = 5.802$, $p<0.05$), credit granting decision ($t = 5.092$, $p<0.05$) and credit debt collection ($t = 5.118$, $p<0.05$) were also significant. The study concluded that the efficiency and sustainability of SMEs depends largely on good WCM practices. It is recommended that SMEs operators should take cognizance of WCM practices in order to enhance their performances.

Keywords: Working capital management; performance; practices; small and medium enterprise.

1. INTRODUCTION

Small and Medium Scale Enterprises (SMEs) have been a key source of dynamism, innovation and flexibility in advanced industrialized countries, as well as in emerging countries. They are often described as efficient and prolific job creators, the seeds of big businesses and the fuel of national economic growth [1]. Even in the developed industrial economies, it is the SMEs sector rather than the multinationals that is the largest employer of workers [1].

They facilitate poverty reduction through fiscal transfers and income from employment and firm ownership [2]. Comparatively, most SMEs are not registered as corporate bodies but as sole proprietorship. This makes registration procedures quite simple and a bit easier than the other forms of business registration. Partly due to this phenomenon, SMEs has outnumbered all the other forms of business and could be found almost everywhere across the country.

In spite of their numbers and significance, recent studies showed that 60% of the SMEs fail within the first five years of operation [3]. Majority of them face unique problems which affect their growth and profitability and hence diminish their ability to contribute effectively to sustainable development. These problems include lack of access to credit, inadequate managerial and technical skill, low level of education, poor marketing information, inhibitive regulatory environment, lack of access to technology and poor financial management especially inefficient working capital management [4].

Okpara [5] reported that most SME operators do not have sufficient financial management skills such as bookkeeping, cash and inventory management skills, hence they end up losing track of their daily transactions and cannot account for their expenses and profits at the end of the month which can even threaten their survival [4] Also, most of them do not engage their working capital in such a way as to enjoy maximum profit.

Working Capital is the flow of ready funds necessary for the working of a business. It comprises funds invested in current assets, which in the ordinary course of business can be turned into cash within a short period without diminishing in value and without disruption of the organization [6]. It is a vital element in any organizational setting that requires cogent attention, proper planning and management [7]. Therefore, it is imperative for every business unit to assess its Working Capital Management (WCM) practices to unearth its performance.

The main objective of WCM is to ensure the maintenance of satisfactory level of working capital in a way that will prevent excessive or inadequate availability of working capital [8]. It is important to note that inefficient WCM may not only reduce profitability but also lead to financial crises and its associated effects. According to [9], management of working capital is important for the financial health of all businesses, irrespective of type and size. Specifically, this study explores the impact of WCM practices on the performance of SMEs and suggests strategies to ensure sound WCM practices by SMEs in Nigeria.

1.1 Statement of the Problem

WCM provides critical insight into the state of company's financial position and its importance to the success of SMEs cannot be under estimated. One of the serious challenges faced by most financial managers is how to effectively and efficiently manage working capital in order to maximize their profits. This is because working capital comprises a number of different items and its management is difficult since these are often linked. Hence, altering one item may impact adversely upon other areas of the business.

Poor Management of working capital results in attendant cash flow problems which reduces SMEs profitability and invariably leads to financial crises coupled with its associated effects. However, all the efforts and interventions by financial managers and owners of SMEs to halt the problems affecting their growth and profitability proved abortive [5]. Therefore, this research work shall fill the gap by examining `the impact of WCM practices on the performance of SMEs in Oyo State Nigeria.

1.2 Objectives of the Study

The broad objective of the study is to determine the impact of working capital management on the performance of SMEs in Oyo State, Nigeria.

The specific objectives are:

- To determine the relationship that exists between cash management practices and the performance of SMEs.
- To evaluate the effect of inventory management practices on the performance of SMEs.
- To assess the impact of trade management practices on the performance of SMEs.

1.3 Hypotheses of the Study

In view of the above research questions and objectives, the following hypotheses are constructed:

$^{1}H_o$: There is no relationship between cash management practices and the performance of SMEs

$^{2}H_o$: Inventory management practices do not affect the performance of SMEs

$^{3}H_o$: Trade management practices do not impact on the performance of SMEs

2. LITERATURE REVIEW

2.1 Conceptual Issues

2.1.1 Concept of working capital management

Working capital is an important tool for growth and profitability for corporations. If the levels of working capital are not enough, it could lead to shortages and problems with the day to day operations [10]. Working capital is also called net working capital and is defined as current assets less current liabilities [11].

Net working capital = Current assets – current liabilities

It is the amount of funds that a business has made available to meet the day to day cash requirements of its operations. The management of working capital is important to the financial health of businesses of all types and sizes. The amounts invested in working capital are often high in proportion to the total assets employed and so it is very vital that these amounts are used in an efficient and effective way. A firm can be very profitable, but if this is not translated into cash from operations within the same operating cycle, the firm would need to borrow to support its continued working capital needs [9]. Thus, the twin objectives of profitability and liquidity must be synchronized and one should not impinge on the other for long.

2.1.2 Working capital components

*2.1.2.1 *Cash management*

The purpose of cash management is to determine the optimal level of cash needed for the nature of business operation cycle. The challenge of cash management is to balance the appropriate level of cash and marketable securities that will reduce the risk of insufficient funds for operations and opportunity cost of holding excessively high level of these resources.

*2.1.2.2 *Inventory Management*

Inventories are the product a company is manufacturing for sale and the components that make up the product has classified the various forms in which inventories exist in a manufacturing company as: raw materials, work-in-progress and finished goods. Stocks of raw materials and work-in-progress facilitate production, while stock of finished goods is required for smooth marketing operations.

In the context of inventory management, [12] opined that a firm is faced with the problem of meeting two conflicting needs. First, to maintain a large size of inventories of raw materials, work-in-progress and finished goods for smooth production and uninterrupted sales operations. Secondly, to maintain a minimum investment in inventories to maximize profitability.

*2.1.2.3 *Payables management*

[13] viewed accounts payable (AP) as suppliers whose invoices for goods or services have been processed but have not yet been paid. Organizations often regard the amount owing to creditors as a source of free credit because it has no identifiable interest charges. It is in view of this that accounts payable are always regarded as a major source of working capital financing for firms [12].

*2.1.2.4 *Receivables management*

Accounts receivable (AR) are customers who have not yet made payment for goods or services, which the firm has provided. The objective of debtors (receivables) management is to minimize the time-lapse between completion of sales and receipt of payments.

2.2 Theoretical Framework

2.2.1 Fisher's separation theory

According to [14], the idea of the Fisher's Separation theory is "Given perfect and complete financial capital markets, the production decision (investment) is seen as governed solely by an objective market criterion (maximizing wealth) with no regard to the individual's subjective preferences that enter into the consumption decision". The Fisher's separation theory tries to explain that companies should avoid confusion between an investment and financing investments.

This theory relates to WCM because a company should always separate how much it invest in working capital versus how it will finance working capital. According to the theory, gross working capital is the investment and net working capital the financing of working capital.

2.2.2 Trade-off theory of liquidity

The trade-off theory of liquidity suggests that firms target an optimal level of liquidity to balance the benefit and cost of holding cash. The cost of holding cash includes low rate of return of these assets because of liquidity premium and possibly tax disadvantage. The benefits of holding cash are in twofold: The firms save transaction costs to raise funds and do not need to liquidate assets to make payments.

Secondly the firm can use liquid assets to finance its activities and investment if other sources of funding are not available or are extremely expensive. This theory is very important for the study because the essence of any working capital management practice is to reduce cost and maximize benefits related to working capital items. As stated above the businessmen gets to understand that the best practice is to maintain an optimal level of liquidity.

3. METHODOLOGY

3.1 The Study Area

The study was carried out in Oyo sate, Nigeria. It is an inland state in South -Western Nigeria and was formed in 1976, bounded in the North by Kwara state, in the east by Osun state, in the South by Ogun State and in the West partly by Ogun State and partly by the Republic of Benin [15]. The state is made up of three senatorial districts and thirty three local Government areas with Ibadan as its capital. Six local governments were purposively selected and they are Atiba, Oyo West, Oyo East, Afijio, Akinyele and Iseyin Local Governments.

3.2 Population and Sample Size of the Study

The population of the study consists of the entire pure water sachet, bakeries and block making industries that are registered in their respective associations in the selected local government areas. 150 respondents were chosen randomly for the study. Structured questionnaires were used to collect data which were analysed using both descriptive and inferential tools such as Frequency counts, Percentages, Multiple Regression Analysis and Spearman Rank Correlation Coefficient.

4. EMPIRICAL RESULTS AND DISCUSSION

4.1 Relationship between Cash Management Practices and the Performance of SMEs

The result of the Spearman Rank Correlation Coefficients as indicated in Table 1 showed that there is a strong positive relationship between SMEs' performance and Cash management practices ($R=0.612$, $p<0.01$).This implied that the more efficient the cash management practices of an enterprise, the better its performance. This assertion is supported by several researchers who also found out that the performance of a business is correlated positively to cash management practices [16-18].

Moreover, this finding is in consonance with the report of [19] who suggested that the implementation of a good cash management system will ensure better control of financial risk, increase the opportunity for profit, strengthen the company's balance sheet, ensure increased confidence in the company and improve operational efficiency.

4.2 Effect of Inventory Management Practices on the Performance of SME

The effect of inventory management practices on the performance of SMEs was analyzed using multiple regression analysis and three variables were considered in the model as determinants, the result is as shown in Table 2.

The multiple regression line is as written below

$$Y= 1.112 - 0.396X1+ 0.220X2 + 0.260X_3$$

Adjusted R^2 is 0.789 and this implied that 78.9 percent of the variation on performance is explained by the three variables considered in the model. In consonance with these findings, the three predictors which are inventory shrinkage, inventory investment and inventory turnover were found to have significant relationships with the performance of SMEs. Both inventory investment and inventory turnover had positive relationships with SMEs performance except for inventory shrinkage which exhibited a negative relationship with performance of SMEs.

The result revealed that a unit increase in inventory shrinkage ($t = -2.506$, $p<0.05$) will lead to a 0.39 decrease in performance of the SMEs. This implied that inventory shrinkage has a significant role in determining SMEs performance. The result support the findings of [20] who posited that inventory ordering systems reflect part of the strategies available to an organization in meeting its inventory management objectives. As such, stock shortages lead mostly to serious hardships for most organizations and tend to affect the overall performance of the SMEs. The respondents stated that employees' theft, expired inventory/stock and stock out affects the performance of SMEs to a great extent. This report is in line with the findings of [21,22] who also found out that inventory shrinkage affect a firm's performance negatively to a very large extent.

Moreover, the result revealed that a unit increase in inventory turnover ($t = 1.922$, $p<0.05$) leads to 0.260 increase in performance and a unit increase in inventory investment ($t = 1.967$, $p<0.05$) also leads to 0.220 increase in SMEs performance. This indicated that inventory investment and turnover had both positive and significant effects on SMEs performance. Most studies have found relationship between inventory turnover and financial performance to be significant [23,9]. Mathuva [24] observed positive relationship between inventory turnover and corporate profitability by using sample of 30 listed firms in Nigeria Stock Exchange. Also, [25] found the relationship between inventory turnover and financial performance to be significantly positive.

4.3 The Impact of Trade Credit Management Practices on the Performance of SMEs

The impact of trade credit management practices on the performance of SMEs was analyzed using multiple regression analysis and three variables were considered in the model as determinants, the result is as shown in Table 3. The multiple regression line is as written below

$$Y= 0.844 + 0.233X1+ 0.256X2 + 0.243X_3$$

Adjusted R^2 is 0.618 and this implied that 61.8 percent of the variation on performance is explained by the three variables considered in the model. In consonance with these findings, the three predictors which are credit policy, credit granting decision and credit debt collection were found to have significant and positive relationships with the performance of SMEs. The result revealed that a unit increase in credit granting decision ($t = 5.802$, $p<0.05$) will enhance the performance of SMEs by 0.233 units.

This showed that the more effective the credit granting decisions in an enterprise, the better their performances. This report is supported with the findings of [26,27] who found out that good credit granting decisions brings about increased sales, attracts customers patronage and helps to strengthen long term relationships with their customers.

Furthermore, credit debt collection policies had significant positive effect on SMEs profitability as findings revealed that a unit increase in credit debt collection policies (t = 5.092, p<0.05) enhanced the performance of SMEs by 0.256 units. This indicates that for an enterprise to be successful, credit debt collection policies must be in place and failure by the enterprise to ensure credit debt collection policies in its operations will affect the profitability of the enterprise negatively. Atrill P. [28] found out that majority of the SMEs lack proper debt collection procedures, hence, they tend to experience increased risks of late payment and default by debtors. Also, in a recent study by [29] debt collection was identified by 55% to be among the top five major challenges facing micro and small businesses, this not only threatens its profitability but also long term sustainability.

Moreover, credit policy also have positive and significant effect on SMEs performance as findings revealed that a unit increase in credit debt collection policies (t = 5.118, p<0.05) enhances the performance of SMEs by 0.243 units. Hence, enhancing credit policies in an enterprise will stimulate profitability. This study is also in agreement with the report of [30] who found out that a sound credit policy would help improve prudential oversight of asset quality, establish a set of minimum standards, and to apply a common language and methodology.

Table 1. The relationship between cash management practices and performance of SMEs

Parameters	Variables		Performance	Cash management
	Performance	Correlation Coefficient Sig. (2 tailed)	1.000	
Spearman rho	Cash management	Correlation Coefficient Sig. (2 tailed)	0.612 0.000	1.000 0.000

*** Correlation is significant at 0.01 level (2 tailed)*
Source: Field survey, 2017

Table 2. Multiple regression result showing the effect of inventory management practices on the performanc of SMEs

Model summary Model	R	R square	Adjusted R square	Std. error of the estimate
1	.908	.825	.789	.65323

a Predictors: (Constant), inventory shrinkage, inventory investment and inventory turnover

Model	Unstandardized coefficients		Standardized Coefficients	T	Sig.
	B	Std. error	Beta		
Constant	1.112	1.223		0.917	0.000
Inventory shrinkage	-0.396	0.204	-0.155	-2.560	0.016
Inventory investment	0.220	0.096	0.215	1. 922	0.018
Inventory turnover	0.260	0.056	0.453	1.967	0.017

Dependent Variable: Net Profit Margin
Source: Field survey. 2017

Table 3. Multiple regression result showing the impact of trade credit management practices on the performance of SMEs

	Unstandardized coefficient		Standardized coefficient		Sig
	B	Std. error	Beta	T	
Constant	0.844	0.135		6.271	0.000
Credit Granting Decision	0.233	0.046	0.279	5.802	0.018
Credit Debt Collection	0.256	0.053	0.249	5.092	0.022
Credit Policy	0.243	0.048	0.236	5.118	0.014

Dependent variable: performance of SMEs
R square = 0.622, Adjusted R square = 0.618; F = 139.914; Significant level 5%
Source: Field survey. 2017

5. CONCLUSION AND RECOMMENDATION

Small and Medium Scale Enterprises constitute a vital engine in economic growth and development of any nation. In spite of the fact that SMEs are the engine room behind a nation's development, yet this sector is bedeviled by several constraints amid poor working capital management which continues to mar its laudable objectives. Against the background of the foregoing, the study examined the impact of working capital management practices on the performance of SMEs in Oyo State, Nigeria.

The result of the analysis showed that significant and positive relationship exists between SMEs' performance and Cash management practices. Furthermore, it was discovered that inventory management practices also had significant effect on SMEs performance as the three predictors which are inventory shrinkage, inventory investment and inventory turnover were found to have significant impact on the performance of SMEs. Also, trade credit management practices impacted significantly on the performance of SMEs as the three predictors which are credit policy, credit granting decision and credit debt collection were found to have significant and positive relationships with the performance of SMEs.

Therefore, good working capital management practices are of significant value to the performance of SMEs as it brings about operational efficiency and increased sales, attracts customers' patronage and helps to strengthen long term relationships with customers.

The following recommendations are made based on the findings:

- SMEs should put emphasis on proper cash management practices. They should also improve their cash management policies by adopting appropriate policies like banking, investing, budgeting and planning for cash requirements.
- SMEs should adopt the daily stock control policy in order to have an optimal inventory level, which would reduce the cost of holding and ordering and, as a result maximize profitability in turn.
- SMEs need to adopt liberal credit policy and carry out thorough credit vetting to ensure reduced costs of bad debts and debt administration costs.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

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Peer-review history:
The peer review history for this paper can be accessed here:
http://sciencedomain.org/review-history/20317