PDF - WORKING CAPITAL MANAGEMENT AND FINANCIAL PERFORMANCE OF LISTED MANUFACTURING FIRMS IN NIGERIA - researchcub.info**ABSTRACT**

This possibility of a firm to survive both in the short run and long-run depends on how effective and efficient management of working capital is. Working capital management has to do with the provision of adequate Cash, inventory, debtors resources and goal attainment of a firm. Many manufacturing firms have an in balance in maintain adequate liquidity to run business and this required to be contributes to the profits and wealth maximization of shareholders. The data collected for the study were Secondary Source, mainly annual reports and accounts of the three companies Seven-Up Bottling Co. Plc, Cement Company of Northern Nigeria Plc., Sokoto Cement and the Okomu Oil Palm company Plc for five years (2010-2014) were analyzed using ratio analysis. This study finds out that, return on assets (ROA) does not increase as a result of negatively result show on cash ratio. And by implication there are problem in term of return on assets position of the company, and owing to the declining, working capital of the company may not be able to meet its payment scheduled (short term obligation as at when due). Based on the findings of the study, it is therefore, recommended that the company should identify and adopt suitable working capital policy and determines its optimum working capital management requirement.

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CHAPTER ONE

INTRODUCTION

1.1. Background to the Study

Working capital is a measure of both a company's efficiency and its short term financial health. The working capital ratio is use to determine whether a company has enough short term assets to cover it short term debt. Anything below 1 indicate negative working capital (ALP) while anything above 2 means that the company is not investing excess assets. Most believe that a ratio between 2:1 and 2:0 is sufficient, also known as net working capital.

Working capital management however deals with management of Current Asset and current Liabilities which directly affect profitability and financial performance of manufacturing firms. This means that manufacturing firms should ensure adequate management of working capital especially cash conversion cycle components of account receivables, account payables and inventories, as efficient working capital management is expected to contribute positively to the financial performance of

manufacturing firms.

The financial performance of manufacturing firm is positively related to the amount of investments in total assets and sales. It is on the other hand negatively related to cost of production.

The lower the cost of production, the higher the financial performance of manufacturing firm.

The management of working capital has profitability and liquidity implications and proposes most important profitability on working capital management. To reach optimal working capital management of the firm manager should control the trade off between profit maximization and liquidity accurately.

An optimal working capital management is expected to contribute positively to the creation of firm value while, an improper management of component of working capital (that is accounts receivable, account payable and inventories) will result into the difficulties in firms continued operation and consequently financial performance of the firm will also suffer.

According to Deloof (2003), the way the working capital is managed has a significant impact on profitability of manufacturing firms. This means that there is a certain level of working capital requirements which potentially maximizes, returns. Other area on the field of working capital management focus on the routines employed by firms. There is a strong relationship between the cash conversion cycle of a firm and its profitability. The three different components of cash conversion cycle (account payables, account receivables and inventory) can be managed in different ways in order to maximize profitability or to enhance the youth of the firm. Sometimes trade credit is a means of attracting new customers. Many firms are prepared to change their standard credit terms in order to win new customers and to gain large order. More-so, credit can stimulate sales because it allows customers to access product quality before paying.

Therefore, it is up to the individual manufacturing firm to determine whether

‘marketing’ approach should be used in working capital management through credit extension. Meanwhile the financial department of such a firm will face cash flow and Liquidity problems since capital will be invested in customers and inventory respectively.

In order to have maximum value, equilibrium should be maintained in account receivable account payable and inventory. According to Pike & Cheng (2001), credit management seeks to create, safeguard and realize a port folio of high quality accounts receivable. Given the significant investment in account receivable by most large firms, credit management policy choices and practices could have important implications on firms value.

Successful management of resources will lead to firm profitability. But would the management success measure, since a period of “credit granting” might result to increase sales and market share whilst supported by decreased profitability or the opposite and since working capital management is best described by the cash conversion cycle, there is need to establish a link between profitability and management of the cash conversion cycle.

The optimum level of inventories will have a direct effect on profitability since it will release working capital resources which in turn will be invested in the business cycle, or will increase inventory levels in order to respond to higher product demand. In the same vein, both credit policy from suppliers and credit period granted to customers will have an impact on profitability. In order to understand the way working capital is managed, cash conversation cycle and its components will be statistically analyzed. The manufacturing firms should ensure adequate management of working capital especially cash conversion cycle components of account receivables, account payables and inventories, as efficient working capital is expected to contribute positively to the financial performance of manufacturing firms.

1.2. Statement of the Problem

Working capital is a necessary ingredient that constitutes the invaluable component for

the day to day activities of manufacturing firms. It involves short term investment of various types. Its components such as cash inventory, account receivable, marketable securities etc. determining the future prospects of a firm. Therefore, they have to be accurately determines and properly combined in order to maximize profit and wealth of shareholders of manufacturing firms.

Problems do exist on how to strike and imbalance between permanent and fluctuating working capital. A firm has to maintain adequate liquidity to party employees make cash purchase and pay creditors/suppliers as at when due, and at the same time not to keep an ideal cash. Maintaining an optimum inventory level requirement for efficient and smooth production and sells are also problems. A level below optimum may cause stock-out which lead to loose of customers and a level above optimum can lead to unnecessary cost, like holding cost to be incurred. Other problems are how to take good care of debtors and the analysis of marketable securities. There is a need to make necessary adjustment between the profitability on account receivable and risk (including the cost of administrating the debt).

These problems affect to a great extend the profitability of manufacturing firms. There by making their production below capacity, insolvency and even shutdown of a firm.

1.3. Objectives of the Study

i. To examine the effect of current ratio on ROA of manufacturing firms in Nigeria.

ii. To determine the influence of quick ration on ROA of manufacturing in Nigeria.

iii. To investigate the impact of cash ratio on ROA of manufacturing in Nigeria

1.4. Statement of Hypothesis

HO1 Current ratio has no significant impact on ROA of manufacturing firms in Nigeria.

HO2 Quick ratio has no significant impact on ROA of manufacturing firms in Nigeria

HO3 Cash ratio has no significant impact on ROA of manufacturing firms in Nigeria.

1.5. Research Questions

In order to effectively carry out this research work, the following research questions

were prostituted:

i. Is current ratio has any effect on return on assets (ROA) of manufacturing firms in Nigeria?

ii. Is quick ratio has any effect on return on assets (ROA) of manufacturing firms in Nigeria?

iii. Does cash ratio has any impact on return on assets (ROA) of manufacturing firms in Nigeria?

1.6. Scope of the Studies

The research at hand is to examine working capital management and financial performance of quoted manufacturing firms in Nigeria with effect from 2010 – 2014.

1.7. Significance of the Study

Working capital management have been recognized worldwide as a measure of both company's efficiency and its short term financial health.

A well and implemented working capital management is expected to contribute positively to the management efficiency, the shareholder earning, the creditor and government expectation and the creation of firm value.

Working capital management and financial performance is significant for the following reasons:

1. **Strategic Purpose:** To compare the current assets and current Liabilities and use the current ratio to determine whether business is solvent or insolvent.

2. **For Tactical Purpose:** To enable management to determine and control the financial performance towards the achievement of set goals of the company.

3. **For Planning Purpose:** To compare the relative benefit accruing from the use of different inputs, or varying proportion of the same inputs currently and over longer periods as the basis for considering alternative adjustment over future period.

1.8. Plan of study

This research work will be divided into five chapters in which chapter one consist of

background of the study, statement of the problem, objective of the study, hypothesis/research question of the study, scope of the study, significant of the study. Chapter two consist of literature review, introduction, conceptual framework, review of empirical study, theoretical framework. Chapter three consist of research methodology, introduction, research design, population and sample of the study, source and methods of data collection, techniques of the data analysis, variation measurement, model specification. Chapter four consist of data presentation on an analysis, introduction, data presentation, descriptive statistic, inferential statistic, summary of major finding, policy implication of the finding. Chapter five consist of summary conclusion and recommendation, summary, conclusion, recommendation, limitation of the study, area of further studies

1.9. Definition of Terms and Abbreviation

Working Capital: This is defined as a measure of both a company's efficiency and its short term financial position. It is calculated as:

Working Capital:Current Assets – current Liabilities (CA – CL).

Management is defined as the coordination of all the resources of an organization through the process of planning, organizing, directing and controlling in order to attain organization objectives.

Working Capital Management

This is defined as the management of current assets and current liabilities and its components of account receivable, account payable and inventories which affect profitability of firms.

Financial Performance

This refers to the amount of investment funds on the total assets and sales

Current Assets (CA)

These are assets that can last for a short period of time e.g stock of good cash in hand, cash at bank, prepaid expenses and marketable securities.

Current Liabilities (CL)

These are liabilities which are payable within a short period of time, usually a year. Current Liabilities to give working capital.

Current Ratio (CR)

Current Ratio is a liquidity ratio that measures company's ability to pay short term and long term obligation.

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Quick Ratio (QR)

This measures the amount of liquid assets available for every amount of current liabilities. e.g cash, marketable securities are quick source of cash.

$$\text{Quick Ratio} = \frac{\text{Current Assets} - \text{inventories}}{\text{Current Liabilities}}$$

Return on Assets (ROA)

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Regards!!!