PDF - THE IMPACT OF WORKING CAPITAL MANAGEMENT ON THE SURVIVAL OF A MANUFACTURING COMPANY(A CASE STUDY OF NIGERIA BOTTLING COMPANY PLC ABA) - researchcub.info**ABSTRACT**

Working capital management involves the management of the most liquid resources of the firm which includes cash and cash equivalents, Inventories and trade and other receivables. Most firms do not hold the correct amount of working capital and this has been a major obstacle to their overall profitability. The study analyzed the impact of working capital management on the profitability of manufacturing firms listed on the Nigeria bottling company . The study utilized a diagnostic research design and targeted the 9 listed manufacturing firms trading on the Nairobi Securities Exchange. However, the study covered 6 of the targeted manufacturing companies, 3 were either not trading or had in complete records at the time of the study. Data was obtained from document analysis of consolidated financial reports of years ending December: 2006, 2007, 2008, 2009 and 2010. Multiple regression and correlation analyses were carried out on the data to determine the relationships between components of working capital management and
the gross operating profit of the firms. The study established that gross operating profit was positively correlated with Average Collection Period and Average Payment Period but negatively correlated with Cash Conversion Cycle. The relationship between Inventory Turnover in Days and gross operating profit was insignificant. Profitability of manufacturing firms depends upon effective working capital management. The study therefore recommended that managers should focus on reducing cash conversion cycles, collect receivables as soon as possible because it is better to receive inflows sooner than later and delay payment of creditors in order to invest the money in short term securities which are profitable.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The term working capital has several meanings in business and economic development finance. In accounting and financial statement analysis, working capital is defined as the firm's short-term or current assets and current liabilities. Net working capital represents the excess of current assets over current liabilities and is an indicator of the firm's ability to meet its short term financial obligations (Brealey & Myers, 2002). Effective working capital management consists of applying the methods which remove the risk and lack of ability in paying short term commitments in one side and prevent over investment in these assets in the other side by planning and controlling current assets and liabilities (Lazaridis & Tryfonidis, 2006). Working Capital Management is the administration of current assets and current liabilities. It deals with the management of current assets and current liabilities, directly affects the liquidity and profitability of the company (Deloof, 2003; Eljelly, 2004; Raheman and Nasri, 2007; Appuhami, 2008; Christopher and Kamalavalli, 2009; Dash and Ravipati, 2009). Current liquidity crisis has highlighted the significance of working capital management.

Management of working capital has profitability and liquidity implications and proposes a familiar front for profitability and liquidity of the company. To reach optimal working capital management firm manager should control the tradeoff between profitability maximization and liquidity accurately (Raheman &Mohamed, 2007). An optimal working capital management is expected to contribute positively to the creation of firm value (Howorth & Weshead, 2003; Deloof, 2003; Afza &Nazir, 2007). Working capital management is important due to many reasons. For one thing, the current assets of a typical manufacturing firm accounts for over half of its total assets. For a distribution company, they account for even more. Excessive levels of current assets can easily result in a firm's realizing a substandard return on investment. However firms with too few current assets may incur shortages and difficulties in maintaining smooth operations Horne and Wachowicz, (2000). Efficient working capital management involves planning and controlling.

There must be a balance between current assets and current liabilities so as to eliminate the risk of inability to meet short term obligations on one hand and avoid excessive investment in these assets on the other hand (Eljelly, 2004). Many surveys have indicated that managers spend considerable time on day-to-day problems that involve working capital decisions. One reason for this is that current assets are short-lived investments that are continually being converted into other asset types (Rao, 1989). With regard to current liabilities, the firm is responsible for paying these obligations on a timely basis. Liquidity for the ongoing firm is not reliant on the liquidation value of its assets, but rather on the operating cash flows generated by those assets (Soenen, 1993). Taken together, decisions on the level of different working capital components become frequent, repetitive, and time consuming.

Working Capital Management is a very sensitive area in the field of financial management (Joshi, 1994). It involves the decision of the amount and composition of current assets and the financing of these assets. Current assets include all those assets that in the normal course of business return to the form of cash within a short

period of time, ordinarily within a year and such temporary investment as may be readily converted into cash upon need. The Working Capital Management of a firm in part affects its profitability. The ultimate objective of any firm is to maximize the profit. But, preserving liquidity of the firm is an important objective too. The problem is that increasing profits at the cost of
liquidity can bring serious problems to the firm (Shin and Soenen, 1998). Therefore, there must be a trade- off between these two objectives of the firms. One objective should not be at cost of the other because both have their importance. If we do not care about profit, we cannot survive for a longer period. On the other hand, if we do not care about liquidity, we may face the problem of insolvency or bankruptcy. For these reasons working capital management should be given proper consideration and will ultimately affect the profitability of the firm. Firms may have an optimal level of working capital that maximizes their value (Afza and Nazir, 2009).
Working Capital Management has its impact on liquidity as well as on profitability of the firm. The study analyzed the relationship between different variables of working capital management including the Average collection period, Inventory turnover in days, Average payment period, Cash conversion cycle and Current ratio and the gross operating profit. Debt ratio, size of the firm (measured in terms of natural logarithm of sales) and financial assets to total assets ratio were used as control variables

1.2 statement of problem

The efficient management of working capital is very vital for a business survival. This is premised on the fact that having too much capital signifies inefficiency where as too little cash in hand signifies that the survival of the business is shaky. Most business organizations do not hold the right amount of stocks, debtors and cash. Due to this reason the firm is unable to meet its maturing short term obligations and its upcoming operational needs. Lack of adequate working capital also means that a firm is unable to undertake expansion projects and increase its sales, therefore limiting the growth and profitability of the business. Majority of listed manufacturing firms have exhibited dwindling returns as well as poor stock performance in the last five years. However, the extent to which working capital management affects profitability of these firms is not well known. It is on this premise that this study analyzed the relationship between working capital management and the firm’s gross operating profit.

1.3 Purpose of the study

The purpose of the study was to analyze the impact of working capital management on profitability of listed manufacturing firms trading on the Nigeria bottling company.

1.4 Objectives of the study

1.4.1 General objective

The general objective of the study was to determine the relationship between working capital management and the profitability of listed manufacturing firms in Aba Securities Exchange.

1.4.2 Specific objectives

The study was guided by the following specific objectives:

To analyze the relationship between average collection period and profitability of listed manufacturing firms.

To assess the relationship between inventories turnover in days and profitability of listed manufacturing firms.

To establish the relationship between average payment period and profitability of listed manufacturing firms.

To evaluate the relationship between cash conversion cycle and profitability of listed manufacturing firms.

1.5 Research Hypotheses

The following hypotheses were tested at =0.05.

H01: There is no statistically significant relationship between average collection period and profitability of listed manufacturing firms.

H02: There is no statistically significant relationship between inventory turnover in days and profitability of listed manufacturing firms.

H03: There is no statistically significant relationship between average payment period and profitability of listed manufacturing firms.
H04: There is no statistically significant relationship between cash conversion cycle and profitability of listed manufacturing firms.

1.6 Significance of the Study

The study's findings may help the manufacturing firms and other companies in general improve on their financial decision making so as to optimize the value of the shareholders and maintain a favorable trade- off between liquidity and profitability. The findings may also be of great benefit to future researchers in the field of working capital management in providing relevant literature in building up the course of study. It may benefit other scholars and students of finance who may use the findings for academic purposes. With the working capital management playing a major role in financial stability of different firms its efficient utilization is necessary in achieving the goals of financial stability. The study recommended ways through which working capital can be effectively utilized in financial decision making. This effective utilization in the long run will increase wealth of the shareholders.

1.7 Scope of the Study

The study focused on the components of WCM, namely average collection period; average payment period; inventory turnover in days and cash conversion cycle and their impact on gross operating profit. The study was limited to the 9 manufacturing companies trading on the Aba Securities Exchange and the consolidated financial records from the year 2006 to 2010.

1.8 Limitations and Delimitations of the Study

The first limitation of the study was that three out of the nine companies targeted by the study were either not trading or had in complete records at the time of the study. It was therefore not possible to obtain their consolidated financial reports for the period covered by the study, thus the findings of the study may not be generalized to these companies. Secondly, the financial managers of some of the companies studied were not willing to provide all the financial records that formed the main data sources for the study. This limitation was overcome by sourcing the missing information from the archives of the Aba Stock Exchange where the companies were listed, since the firms are public entities whose transactions are records must be made available to the public.

1.9 Definition of Significant Terms Used in the Study

The following terms assumed the stated meanings in the context of the study:

Average collection period (ACP): refers to the average time required for changing the company's receivables into cash. It is calculated as:

ACP =

______ ___ ________ × 365

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Average payment period (APP): refers to the average number of days a company takes to pay off credit purchases. Average Payment Period is calculated as:

APP =

______ ________ × 365

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Cash conversion cycle (CCC): The sum of days of sales outstanding (average collection period) and days of sales in inventory less days of payables outstanding (Keown et al., 2003). It is calculated as:

Inventory turnover in days (ITID): is the average required time to change the materials into the product and then sell the goods. It is calculated as:

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Working capital: Working capital, also known as net working capital or NWC, is calculated as current assets minus current liabilities. The major components of working capital are accounts receivable, inventories, cash and cash equivalents and accounts payable.

Cash

Conversion

Cycle

Days of Sales

outstanding

Days of Sales

Inventory

Days of

Payables

outstanding