

An Empirical Analysis of Corporate Survival and Growth: Evidence from Efficient Working Capital Management

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ABSTRACT

A lot of corporate organizations could not live to achieve their objectives due to inefficiency in the management of its working capital. Every organization, both private and public needs sufficient working capital to enable it meet up with its daily basic financial obligations. The objectives of this research work are: to examine efficient working capital management as a prerequisite to corporate survival and growth; to find out what makes up working capital and if possible the best combination; and to suggest some measures for improvement in working capital management. The researcher of this work used desk research method and the findings were that: the risk of changes in demand or technology leaves surplus stock unsalable; the risk of inability to settle financial obligations as at when due, and excess liquid capital tied up unproductively. The following recommendations were made which includes: the financial manager should have knowledge of the sources of working capital funds as well as investment opportunities where idle funds may be temporarily invested; the management decisions concerning working capital should not be left to the financial manager only and when any company manages its working capital well, it has every leverage opportunity to continue in business indefinitely (both in profitability and in liquidity).

Introduction

The existence, survival, growth and stability of any corporate body is highly dependent on the efficiency and effectiveness of its management. This is measured by the ability of the organization's management to combine all the necessary material for optimal and efficient actualization of their set objectives within the stipulated time. In any organization, cash forms the life wire, which determines to a large-extent, its growth, existence and survival among other competing firms. As a result, it becomes imperative for the management of any organization to give a close attention to the management of working capital if they want to stand the test of time. The management decides the best proportion of its investment on both fixed and current assets and finally her liability level

to enable improvement and correction of imbalances in the liquidity position of the firm. Most organizations believe in profitability, but it is generally accepted that liquidity is more important for survival and growth. The reason behind this premise is that most organizations make profit but do not possess enough or adequate, liquid asset to off-set current obligations. However, this inability to make payment at when due may definitely have serious consequences on the organization financial growth. Weak liquidity makes it unsafe and unsound for the survival of the company but all it takes is efficient and effective management.

Efficiency means doing something with little or no wastage especially in terms of time, energy and money. In other words, it is the achievement of great task with less than the proportionate factor input. According to Okafor and Udu (2002, p. 84), "Efficiency is the ability to work well without wasting time and resources." Also, Horby (2000) stated that efficiency is doing something well and thoroughly with no waste of time, money or energy. This is to say that the achievement outcome is far greater than the resources put in to achieve the defined outcome. Efficient working capital management involves the mix of the current assets, current liabilities and fixed assets of the business in order to meet up with the day to day need of the business in question or in other words to keep the business going with less waste especially in terms of time, energy and goodwill. Nwankwo (2005) opined that efficient working capital is based on the decision of the management of the company in determining the volume of current assets over current liabilities that the company is prepared to have in the company's balance sheet. Ibenta (2005, p. 406) further defined working capital management as "all aspects of the administration of both current assets and current liabilities. It is the firms' investment in short term assets – cash, short term securities, account receivable and inventories."

Working capital management has to do with using the money that is needed to run the day-to-day operations of an organization efficiently in order to achieve the aims and objectives of the organization, basically profit making and growth, and good financial standing. Efficient working capital management is a continuous process that involves a number of day-to-day operations and decisions that determine the following:

- The firm's level of current assets investment,
- The specific sources and mix of short-term credit the company should use,
- The level of investment in each type of current assets, and
- The level of short term and long term debt the firm will use to finance its assets.

In the same regard, Block and Hirt (1992, p. 8) defined it as:

working capital management involves financing and management of the current asset of the firm. The financial managers probably devote more time in working capital management than to any other activity. Current assets, by their nature, are changing daily, if not hourly, and management decision must be made.

Close relevant operations in financial management has disclosed that working capital management is unavoidable for corporate growth and survival as was viewed by (Pandey, 2006). To achieve efficient working capital management, it is worthy to note the issue of uncertainty that is inherent in this present day's economic/business environment. According to Brockington (1996, p. 205), "it threatens the survival and growth of every

business, thus making sound liquidity and cash management a point of interest in corporate planning.”

Bananda, Ldama, and Itolo (2008) substantiated the fact by stating that the importance of management of liquid asset has been gradually and systematically gaining prominence and growth in the most manufacturing companies or firms (Soyaduzzaman, 2006; Shin & Soenen, 1998). This incidental prominence and growth of liquidity management makes it very apparent that no firm can survive without an efficient and effective management of its net working capital which is total current assets less total current liabilities. The rationale for working capital management is the fact that current assets characteristically constitutes more than half the assets of most businesses and the size and relative volatility of these assets makes it necessary for such assets to be monitored closely. Finally, efficient working capital management is crucial to small, medium and large organizations because if the efficiency and effectiveness of managing working capital is not available, no amount of finance provided will transform a financially weak organization into a strong and viable organization with a remarkable reputation that would stand the serve test of time.

Net working capital (current assets minus current liabilities) has always been an important measure of a company’s liquidity and its ability to support growth. But too much working capital usually means that too much money is tied up in account receivable and inventory. Buchmann, Roos, Juna, and Martin (2008) stated that the knee-jerk reaction to this problem is to aggressively collect receivables, ruthlessly suppressing payments to supplies, and cutting inventory across the board. But this only attacks the symptoms of working capital issues not the root cause of the problem.

However, despite all the implicit and explicit costs which include among others; the risk of inability to pay bills as at when due; excess liquid capital tied up unproductively; the risk of deterioration due to the length of time in storage and the risk of changes in demand or technology which leaves surplus stock unusable, companies strive to manage its profitability for growth and liquidity for survival. The problem is to identify the difficulties many firms find themselves, when they perceive that profit making is at the expense of running illiquid. This will go along way to identifying the relationship existing between growth and survival in the management of working capital. Thus, the study is to address the issue of efficient working capital as a prerequisite to corporate survival and growth.

Owing to the trend of computerization and globalization of taking the lead in the world today, it becomes worrisome where a firm is over loaded with inventories and other marketable securities when cash is in short supply for payments. And also a situation where a firm is over loaded with idle cash, whereas there are very many profitable investments that could have used some of such cash. This calls for urgent attention if such a firm is to grow and survive the harsh economic and competitive environment that has engulfed today’s business world. Based on the above, the major objective of this research is to examine efficient working capital management as a prerequisite to corporate survival and growth. Other specific objectives include the following:

1. To find out what makes up working capital and if possible the best combination,
2. To examine the management pattern of inventory,
3. To analyze accounts receivable management along with its impact on working capital management,

4. To analyze cash position and the efficiency with which cash is managed, and
5. To suggest some measure for improvement in working capital management.

Literature Review

Working capital in simple term is the amount of funds which a company needs to finance day-to-day operations. Opinions differ on the concept of working capital. Gross working capital is defined as the firm's total current asset. The purpose of the present study is to analyze the various concepts of working capital and find out the feasibility of the concept of the working capital in the light of better planning and control. A concept of gross working capital adheres to the overall investment in current assets and financing of the same. Nunn (1981) noted that net working capital is the excess of current assets over current liabilities. Problems of working capital management involve the problem of determining the optimum level of investment in each component of current assets that is inventory, receivables, cash and other short-term investment. The basic focus of managing working capital should be to optimize the firms' investment in them. An expert (Van Horne) in the financial management is of the opinion that problem of working capital is one of the factors responsible for the low profitability in manufacturing sector. Better planning and control of working capital or in other words, proper utilization of optimum quantity of working capital increases the earning power of the company subject to the existence of operating margin.

Elements of Working Capital

Working capital management is a branch of total quality management that focuses on decision making. It is from this point that Owoh (2002) viewed working capital management to be one of the key ambits of financial management which is decision making driven with particular eye on the organization and arrangement of current assets, current liabilities and fixed assets. This setting will be able to meet up with the Company's financial needs and help the Company carry out its operations perfectly. Again, Alile (1983, p. 4) came up with his own contribution that, the decision making which is the nucleus of working capital management encompasses the following:

- Decision on the company's level of current asset in investment,
- Decision on the level of investment in each type of current asset,
- Decision on the specific sources and mix of short-term credit the company should use, and
- Decision on the levels of short-term and long term debts the company uses for financing activities.

So working capital is the money that is needed to run a business rather than money that is used to buy fixed assets when starting a business. Working capital (Table 1) is the gross current assets which includes such items as cash, marketable securities, accounts receivables, and inventories while the gross current liabilities includes such items as trade creditors, accrued wages, taxes, dividend, Bank overdraft among others. Therefore the net

working capital is total current assets less total current liabilities. This represents those assets that can be turned into cash within one accounting period usually a year.

Table 1

Working Capital

Current assets:	₦' m
Inventory	
Marketable securities	250
Accounts receivables	450
Cash	100
Total current assets	1100
Less: current liabilities:	
Trade creditors	50
Accrued wages	150
Accrued taxes	30
Bank overdraft	150
Other current liabilities	70
Total current liabilities	450
Net working capital	650

Cash: Cash is the most liquid current asset of a firm. Cash include the money in the currency, cash in till and demand deposits held in the bank and even marketable securities (Idam, 2002). Among the current assets of any organization, cash is the most significant of all because it can command every other asset in the organization. Although, cash is the most significant of all the assets, cash is sterile in nature in that it does not generate revenue. Hence, the management of cash position of an organization is very important to financial managers. The financial managers must maintain adequate cash to meet the payment obligations of the company, while any cash excesses should be invested in profitable assets.

Account Receivables: Account receivables are debts owed a company by her valuable customer who are trusted with the goods and services. The amount, duration to pay depends on the character and integrity of the customer. According to Emekekwe (1990, p. 394), "Accounts receivable is an aggregate of all the debts owned to a firm at a particular point in time. It represents the amount a firm expects to receive from its debtors in payment of goods and services delivered or rendered by the firm." Therefore, it is the duty of the financial manager to make decisions as regarding the policy that must be adopted in extending credit facilities to customers because of the problem of possible default.

Inventories: Inventories commonly known as stocks are the least liquid of a company's current assets and could represent significant part of the company's investment. There are three main types of inventories namely; raw materials, work in progress, and finished goods. Raw materials are the stocks that have been purchased and will be used in the process of manufacture while work in progress represents partially finished goods. Finished goods on the other hand, represent those items of stock that are ready to be

monetized. In this regard therefore, the financial manager has to put into consideration the ordering cost, carrying cost and stock out cost of the inventory.

Bank Overdraft: This is credit arrangement whereby the borrower will withdraw funds in excess of the balance in his current account up to certain specified limit during a stipulated time. Interest is charged on utilized amount.

Trade Creditors: In the ordinary course of events, a firm buys its supplies and materials on credit recording the debt as accounts payable or trade credit. Trade credit means a credit that a customer gets from his supplies of goods in the normal course of business.

Accrued Expenses: Accrued expenses represent liability that a firm has to pay for the services, which it has already received. They represent a spontaneous interest-free source of financing. Accrued wages and salaries, taxes and interest are also among the components.

Management of the Three Components of Working-Capital

They are three factors driving working capital levels. These includes: inventory, accounts receivables and bills payables. In effect account receivables and payables are different ways of financing inventory. Companies need to handle the three simultaneously across the board to drive fundamental reductions in asset levels. Given the wide range of possible actions, management focus is critical. A realistic plan with clear priorities is the best approach, since an overly ambitious agenda can stretch internal capabilities and deliver suboptimal results (Dittmar & Smith, 2005). Instead, companies should focus on the most promising actions that would not impair flexibility and performance. These actions will vary depending on the industry and the company's condition, but they should have three overall objectives.

Reduce Inventory: Excess inventory is one of the most over looked sources of cash, in most cases accounting for almost half the savings from working - capital management. By cutting across enterprise processes as well as processes involving suppliers and customers, companies can minimize inventory throughout the value chain. With raw materials, companies can often achieve substantial gains by redefining optimal safety-stock levels and batch sizes. This requires a thorough analysis of customer demand patterns; customer forecast quality, and supplier lead times. By assessing these factors, companies can often sharply reduce inventory levels throughout the supply chain.

Speed Up Receivables Collections: Many companies are early payers and late collectors. Other companies have cash flows problems caused by a mismatch in timing between incurred costs and receipt of customer payments. One way to ensure a steadier flow of cash is to better align incurred costs with customer payments by asking for a down payment and setting up series of staggered payments to ensure that most receivables have been collected by the time of delivery. All companies should aim to reduce overdue payments and accelerate collection and setting up a schedule of escalating payment demands.

Companies should also slowdown their payment terms and conditions against best practice and negotiating with their valued customers. The goal of shortening customers' payment terms, however, must balance the risk of jeopardizing the relationship.

Companies should always seek a fair, mutually beneficial, and non-confrontational solution.

Rethink Payable Terms: Companies are at one end of the business, and then companies that are slow in payment use the unpaid payables as a source of financing at the other end. Between these two extremes is a more effective, integrated approach to payment renegotiation that takes into account all aspects of the customer – supplier relationship, from price and payment terms to delivery time frames. Companies should benchmark terms and conditions against industry best practices and eliminate early payments, except when attractive discounts are offered. When renegotiating payment conditions they should consider the length of their relationship with supplies as well as competitive loyalties. Moreover, linking supplier's payment terms to their performance in areas such as delivery accuracy complaint ratios, and other lead time can improve underlying processes and reduce working capital overall by analyzing each component of working capital along the line, companies can identify and remove the obstacles that slow cash flow. If working capital is managed well it generates more cash for growth along with streamlined processes and lower costs.

Working Capital Theories and Implications

There are basically three theories of working capital, which includes the conservative approach, the aggressive approach and the moderate approach (Nwankwo, 2005). These theories are examined below with their implications.

- **The Conservative Approach:** In this approach permanent capital is being used to finance all permanent assets requirements and also to meet some or all of the seasonal demands. In view of conservative approach to working capital management, a company will keep a large quantity of current assets in relations to the total assets of the company. The implication of this approach is that it yields a lower expected profitability resulting in a lower risk. This type of policy will also increase the company's net working capital situation but the firm will be short of funds to be used in other productive sectors.
- **The Aggressive Approach:** In this approach, the company finances all of its fixed assets with long term capital but part of its permanent current assets with short-term credit (Van Horne, 1980). Under this policy, the company holds relatively small portion of its total assets in form of current assets. The implication of the aggressive approach is that it yields higher profitability resulting in a higher risk and lower working capital.
- **The Moderate Approach:** This strategy minimizes the risk that the company will be unable to pay off its matured obligations. At this limits, a company could attempt to match exactly the maturity structure of its assets and liabilities.

Inventory expected to be sold in thirty days could be financed with thirty days bank overdraft. The implication of this approach is that it yields moderate expected profitability resulting in moderate risk, and the working capital position of the company will be in optimum balance.

As the name implies it is neither aggressive nor conservative but it falls in between the two policies. It is representing moderate situations. The optimal level of

working capital is reached when the degree of returns expected maximizes the shareholders wealth and it must be pointed out that there is no best working capital theory or policy to suit every organization at all times. Lastly, the working capital theories can be better appreciated by the diagram from Moyer, Mcgoigan, and Kretlow (1984).

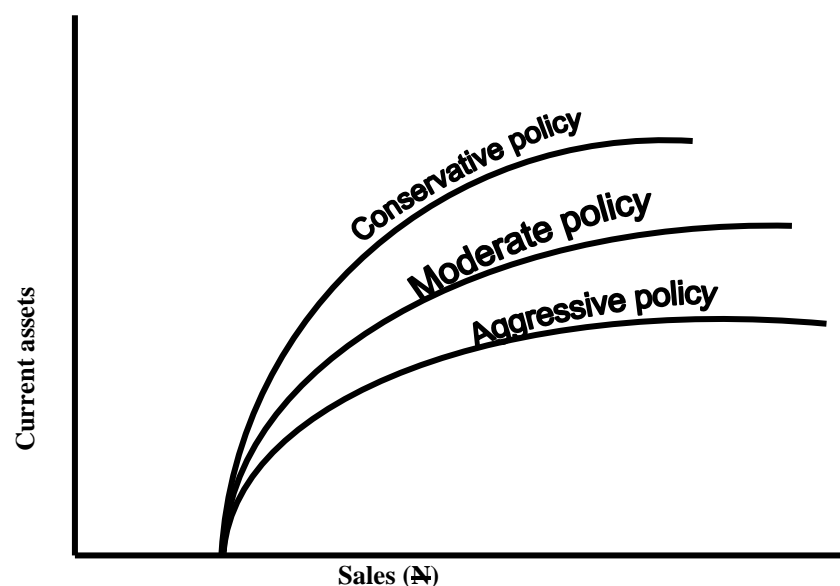


Figure 1. Three alternative working capital investment policies.

Factors Influencing a Firm's Working Capital Management

There are many factors that determine or influence working capital management. Industry practices are significant determinants of a firm's working capital management practices (Hawawini, Viallet, & Vora, 1986). The working capital policies of say a soft drink company are going to be quite different from those of a retail shoe company. Consequently, it is important to control the influence of industry practices on firm's working capital practices. Secondly, firm size may influence the efficiency of a company's working capital management. Larger firms may require larger investments in working capital because of their larger sales levels. Alternatively, larger firms may be able to use their size to forge relationships with suppliers that are necessary for reductions in investments in working capital.

Thus, firm sizes are likely to influence the efficiency of a firm's working capital management, though the direction of the effect is an open question. Thirdly, the proportion of a firm's assets accounted for by fixed assets might exercise an influence on a firm's working capital performance. For example, the inventory problems of an automobile parts manufacturer are likely to be quite different from that of block industry producers. Again the account receivables problems of these types of companies are also likely to be different. Fourthly, company's sales influence the company's working capital position. It is expected that company's expected future sales to influence its working capital investment, and so its cash conversion cycle.

For instance, a company might build up inventories in anticipation of future sales growth, and as a result, may also increase its use of trade credit. Arthur (1992) opined that there are various factors which determine the level of working capital required by a business and such factors include nature of business, market condition, seasonality of operations and condition of supply. These factors are discussed in details as follows:

Nature of Business: This is one of the primarily factors influencing the working capital requirements of a firm. For instance, a manufacturing firm has a longer operating cycle and invests more in its current assets. It thus, has a greater working capital requirement. On the other hand, a service firm like a hotel or entertainment centre has a short operating cycle since it sells mostly on cash basis and has a lower working capital requirement.

Market Conditions: Another major factor influencing working capital requirement is the level of competition. If the competition is high, the company should have enough inventories of finished goods to meet up with certain levels of demand. This will require a greater need of working capital. On the other hand, when competition is low, but demands are high, the company can afford to have a smaller inventory and would consequently require lower working capital.

Seasonality of Operations: Some firms produce seasonal products. Products that are in high demand during a particular period of the year, for instance, sachet water producing companies sell more during the dry season period than in the rainy season. Such firms have greater working capital requirement during peak seasons and lower needs during other seasons. Companies whose sales are not affected by seasons have stable working capital requirements.

Supply Conditions: If supply of raw materials and spare parts is timely, and adequate, the firm can get by with a comparatively low inventory level. If supply is scarce and unpredictable or unavailable during a particular season, the firm will have to obtain raw material when it is available. It would thus need more working capital to carry a large inventory and conduct operations all year round.

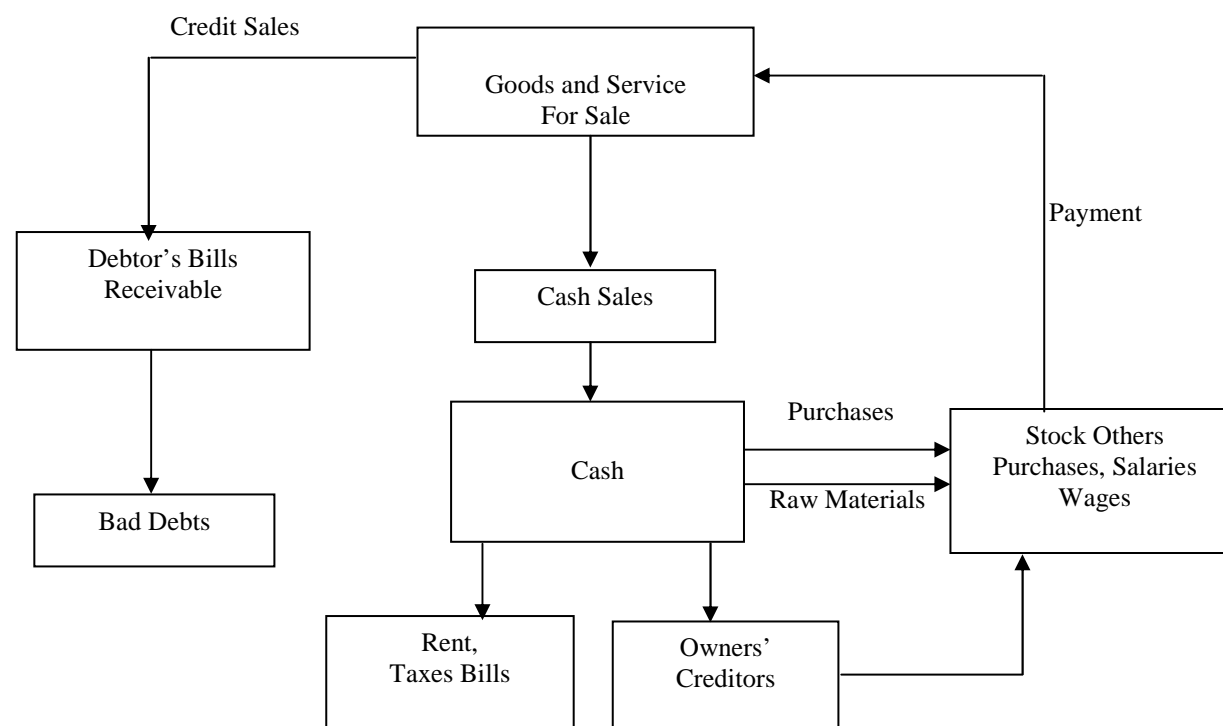


Figure 2. Working capital cycle in a firm.

Working Capital Cycle and Budgeting

Working capital cycle determines the company income; it could be seen as the revolving or operating capital of the business that routinely turn over many times in a year. According to Ibenta (2005, p.401), "It is the length of time between the company's outlay of cash for raw materials, wages and other expenditures and the inflow of cash from sale of the goods.

Looking at the manufacturing company, working capital cycle is the average time that raw materials remain in stock less the period of credit taken from supplies plus the time taken for producing the goods, plus the time the goods remain in finished goods, plus the time taken by credit customers to pay for the goods. This is important in efficient working capital management because this cycle determines the sales, profitability and likelihood of growth and possibly ability to continue in business. As working capital cycle is taking place, working capital budgeting takes its place almost at the same time since sales, capital expenditure and cost budgets are constructed and decisions that will affect working capital and source of finance for the company will be decided simultaneously.

A plan to expand or open new outlets, for example, has implications for amounts of stock held. Plan to build new factories will almost certainly require additional borrowing facilities. According to Anumaka (2007, p. 25), the following issues need to be addressed:

- The changes that are likely to occur in stock values, debtors and creditors,
- Consideration of stock policies, and credit periods (both with debtors and creditors) will be necessary,
- The values which will be tied up in working capitals both during, and at the end of the budget period,
- Evaluation of the major needs for (or repayment of) finance,
- The calculation and implications of interest costs,
- Any plans to raise new funds from shareholders, and
- Evaluation of the firms divided policy.

Importance of Working Capital Management

Working capital management is important to companies because it provides profit through sales that gives rise to growth. It provides liquidity through cash flow that gives rise to corporate stability and existence. Weston and Coperland (1986) have pointed out that working capital management includes a number of aspects that makes it an important topic of study and such aspects includes:

- Surveys indicate that the largest portion of financial manager's time is devoted to the day-to-day internal operation of the firm, which can appropriately be subsumed under the heading of working capital management.

- Characteristically, current assets represent more than half the total assets of a business firm. Because they represent such a large investment and because this investment tends to be relatively volatile, current asset requires financial manager's regular attention.
- The relationship between sales growth and the need to finance current assets is close and direct. Sales increase production and it requires additional inventories and perhaps cash balances. All such needs must be financed, and since they are closely related to sales volume it is imperative that financial manager keep abreast of development in the working capital segment of the firm. Of course, continued sales increase requires additional long-term assets, which must also be financed. Nwankwo (2007) confirmed that working capital has a high turnover rate unlike long-term assets.
- Investments in inventories and accounts receivable are receivable during the company's normal operating cycle when stock are sold and accounts receivable are collected. Ojiuko (2001) went further to illustrate that a manufacturing company's operating cycle consist of three primary activities purchasing resources, manufacturing the product and distributing (selling) the product. These activities create funds flows that are both unsynchronized and uncertain. They are
- unsynchronized, because cash disbursements usually take place before cash receipts. They are uncertain because future sales and costs, which generate the respective receipts and disbursement, cannot be forecasted with complete accuracy.

Concluding Remarks

Efficient working capital is really a prerequisite to growth and existence of corporate enterprises because it dictates the level of production, inventory and sales. Without working capital every aspect of the enterprise will cease to exist that is there will be no money for the day-to day running of the business which is the aim of every business establishment. Well-managed working capital will produce an increased profitability to meet the financial needs of the company at all times. Increasing the corporate setting will bring about good corporate image, going concern ability, increased business value, expansion, peaceful existence amongst workers and management. They are many factors like industry practice, corporate size proportion of a firm's assets in long term, and current assets, market share, nature of business, and business environment are significant determinants of working capital management in an organization.

On the other hand, where there is inefficient management of working capital of a firm, there is every propensity that a lot of mayhem will fall on the organization. Such mishap may range from the setting, inability to expand; reduction in value of the company as well as its shares; inability of the management to cope with the organizational technical improvements; and financial losses, liquidity, susceptibility to liquidation and insolvency. Finally, when any company manages its working capital well, it has every leverage opportunity to continue in business indefinitely (both in profitability and in liquidity). Based on this research work, the researcher has proffered the following recommendations:

- The financial manager should have knowledge of the sources of working capital funds as well as investment opportunities where idle funds may be temporarily invested.
- The current assets at all times should be sufficiently in excess of current liabilities to constitute buffer for maturing obligations within the ordinary operating cycle of a business.
- The management decisions concerning working capital should not be left to the financial manager alone. Other departmental heads should partake for optimality to be attained easily.
- The decision on how to optimize and finance current assets should be highly considered with care.
- Inter firm comparison should be made from time to time in the similar organization.
- Financial information system should be introduced to develop financial discipline in working capital management.
- Working capital Norms for maintaining optimum quantity of raw materials, work-in-progress, finished goods and store, and spares are to be developed.
- Above all financial forecasting, planning and control devices are to be move intensive to enhance the efficiency of cash management.

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