Effective Working Capital Management and the Survival of Business Organizations in Delta State, Nigeria

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ABSTRACT

This survey investigated effective working capital management and the survival of business organizations in Delta State, Nigeria. The study spotlighted the factors that influence the working capital requirements of firms and the symptoms of shortage of working capital and under capital. Structured questionnaire was employed in the course of gathering relevant data for the study and administered randomly on 80 employees of six manufacturing organizations in Delta State selected through multi-stage sampling procedure. Data for the study were presented on tables and analysed using simple percentage. The results showed that there is positive relationship between effective working capital management and the survival of business organisations in Delta State in particular and Nigeria in general. The study observed that effective working capital management minimizes the effect of over-trading and under-trading in the organisations. The study, however, recommended proper management of trade creditors, trade debtors and inventories would enhance the organizations' survival.

Keywords: *Working capital, Management, Organizations' Survival.*

INTRODUCTION

Working capital is the excess of current assets over current liabilities. This is what is referred to in the balance sheet as the net current assets. Working capital therefore represents the funds used to finance production such as the purchase of raw materials, to finance inventories and provide credit to customers. For example, a firm that does not enjoy credit from its suppliers of goods and services would have to raise funds to purchase raw materials, pay salaries and other production overhead costs until the raw material undergo all the manufacturing processes and then become finished goods to be sold. The funds so used until money comes in from the sales of the finished products, is part of the firm's working capital. Also, if some of the sales are on credit, it means that the firm will have to raise additional funds equivalent to the credit sales for the period of the credit given to customers to pay for raw materials, salaries and other costs. This will result in an increase in the working capital. However, the amount of working capital required would decrease if raw materials could be obtained on credit by the amount of credit given. The ineptitude of many business operators in managing organisation's working capital, therefore brought to bear, the question whether effective working capital management has significant relationship with the growing tendency of manufacturing organisations to survive in Delta State.

Working capital management is the administration of the company's current assets and the financing need to support these current assets. It can be viewed as the balancing of the liquidity and profitability objectives of the company as well as taking cognizance of the risk. Akinsulire (2006) views working capital management as the management of all aspects of current assets and current liabilities. Thus working capital management simply means management of various business components such as: cash, debtors, stock and creditors. Shiro (2004) sees that working capital as the capital available for the day to day running of an organization or business. The management of the various components of working capital involves determining the optimal level of which the controllable ones should be maintained at a particular time, level of funds that the management is ready to allocate to the different forms of current assets, how the current assets should be financed, for example, short or long term and the relationship between the levels of fixed assets and current assets (Akinsulire, 2006). Ovwielefuoma (1993) lists some factors which generally influence the working capital requirements of the firms as: production cycle, nature of business, size of business, business fluctuations, credit policy, availability of credit, dividend policy, operating efficiency and price change.

The production cycle commences with procurements and use of raw materials and completes with the production of finished goods. The longer the production cycle, the larger the working capital requirement. The nature of the business has substantial influence on working capital requirements. Trading companies have very little investment in fixed assets relative to the amount required for working capital investment. But in the case of a manufacturing organization, working capital as well as fixed capital are competitively required. The size of the business also plays an important role on working capital requirements. Size may be measured in terms of the scale of operation. As the scale of operation increases, there will be need to build up additional raw materials to meet higher production requirements, additional debtors arising from the additional sales and additional finished goods to satisfy higher sales demand.

However, most companies experience seasonal and cyclical fluctuations in the demand for their products and services. These business variations affect the working capital requirements. Under boom, companies will usually increase the scale of operation necessitating additional investment in both fixed and current assets. On the other hand, under trade recession, sales will fall and consequently, the levels of stocks and debtors will also fall. Another factor that influences working capital requirements is the credit policy of the organisation. The credit policy of the company affects working capital by influencing the level of debtors. A liberal credit policy is expected to lead to high investment in debtors and by extension a higher working capital requirement.

The working capital requirement of a company is also largely affected by credit terms granted by its creditors. Less working capital will be required by a company that enjoys liberal credit terms from his suppliers. Besides, a company, which can get bank credit easily on favourable conditions, will operate with less pressure on working capital requirements than a company without such a facility. The dividend policy of a company also influences the working capital requirements. Payment of dividend consumes cash thus, reduces company's working capital to that extent. If the profits are retained in the business, the company's working capital position will be strengthened, but when the profit is shared among the owners of the business, the management is somehow faced with the working capital demand.

The operating efficiency of a company relates to the optimum utilization of resources at minimum costs. The company will be effectively contributing to its working capital if it is efficient in controlling the operating costs. The use of working capital is improved and pace of each cycle is accelerated with operating efficiency, better utilization of resources improves profits ability and thus, helps in releasing pressure on working capital. General rising price level also requires a company to maintain higher amount of working capital. The same level of current assets will need increased investment when prices are increasing and vice visa.

The symptoms of shortage of working capital are: (i) a low average collection period, (ii) high stock turnover, (iii) a rapid growth in current assets, (iv) a low liquidity ratio; (v) significant increase in overhead costs which may lead to fall in net profit margin. If it is a listed company, its share price will drop, as prospective investors will be unwilling to buy the shares; the firm will not be able to settle suppliers promptly resulting in loss of discount revenue, the firm may miss profitable opportunities due to shortages of liquid resources (Aborode, 2005; Akinsulire, 2006; Ovwielefuoma, 1993 and Shiro, 2004). The symptoms of excessive working capital are high liquidity ratios, low stock turnover, high average collection period, low creditors payment period, losses of interest on capital tie down unnecessarily. It results in unnecessary accumulation of inventories, thus chances of inventory mishandling, waste, theft and losses increase (Shiro, 2004; Aborode, 2005; Akinsulire, 2002 and Ovwielefuoma, 1993).

PARTICIPANTS AND PROCEDURE

This study is a descriptive survey. The population comprises all the manufacturing organisations in Delta State. Multi-stage sampling method was adopted to select 6 manufacturing companies for the study. The respondents were workers of the companies who have knowledge of the relationship between working capital and its management in the organisation. Based on the staff strength of each company, 50% of its workforce were sampled, which gives a total of 90.

Table 1: Manufacturing firms studied with number of respondents in Delta State

S/N	Manufacturing Organizations	No. of Respondents
1.	Vita Foam Plc, Sapele	20
2.	Imoniyame Rubber Holding Ltd, Ughelli	20
3.	Beta Glass Plc, Ughelli	20
4.	Industrial Gas Ltd, Warri	10
5.	Eternit Nigeria Plc, Sapele	5
6.	Nigerian Salt Coy Ltd, Aladja	5
	Total	**90**

Though the 90 copies of questionnaire were not successfully returned, yet a significant percentage (89%) was returned. The questions on the questionnaire were structured properly to produce answers of “Yes” or “No”. This was to enable the respondents attend to the questions without bias. The methods of data analysis included frequency tables and simple percentage.

RESULTS AND DISCUSSION

Table 2: Working capital management and survival of the business

Option	Frequency of Occurrence	Percentage (%)
Yes	77	96.25
No	3	3.75
Total	**80**	**100**

Source: Survey, 2012

The respondents were asked if they have observed any significant relationship between working capital management and the survival of the business. Table 2 shows that majority of the respondents are of the view that effective working capital management helps significantly in the survival of business organizations. This indicates therefore, that there is significant relationship between effective working capital management and the survival of business organizations.

Table 3: Working capital management and its significant relationship with management of surplus working capital

Option	Frequency of Occurrence	Percentage (%)
Yes	78	97.5
No	2	2.5
Total	**80**	**100**

Source: Survey, 2012

On the question whether reinvesting surplus funds, diversifying the business and savings enhanced effective management of the business working capital, majority of them were of the positive opinion. This points to the fact that effective management of working capital has significant relationship with management of surplus working capital in the firms. Working capital if effectively managed, will result in organizations being able to settle suppliers promptly resulting in gain of discount revenue as well as granting credit to customers. It will also result in preventing unnecessary pressure exerted on customers for the payment of their debts. Furthermore, the firm may gain profitable opportunities due to adequate liquid resources if it is a listed company, its share prices will increase, as prospective investors will be willing to buy the shares and the firm will gain its reputation when it is in position to honour its short-term obligations.

Thus, effective working capital management has significant relationship with management of surplus working capital in the organizations under study. Working capital if effectively managed, will prevent unnecessary accumulation of inventories. Thus, chances of inventory mishandling, waste, theft and losses will decrease, losses of interest on capital tie down will be minimized; higher incidence of bad debts will not arise and this will improve profitability. It suffices to state that effective working capital management in organizations would minimize the effect of over-trading and under-tradings. Inventory or stock consists of finished goods, work-in-progress and raw materials. The guiding principle of firms is that its stock levels should be optimal, it should be neither too large nor too small. If stock is too large, excess capital will be tied up in stock unproductive, cost of storage (for example, insurance and warehousing) will rise and there is the risk of deterioration and obsolescence due to the length of time in storage. On the other hand, if it is too low, production may be interrupted due to shortage of stock, frequent ordering will result in increase in ordering costs while the discount on the purchase of large quantity will be lost. The importance of proper cash management cannot be over-emphasized. A highly profitable project can be seriously impeded if cash is not available at the appropriate time to pay for necessary supplies. On the other hand, if the business is carrying too much cash balance, that is an indication that the resources of the business are being wasted. Unfortunately, such a business will not earn sufficient return relative to the capital employed for its resources.

CONCLUSION

This study aims at examining effective working capital management as a tool for organizations survival and proffered solutions for effective management of working capital requirements in organizations. Management of trade debtors requires experience, and in-depth appraisal of the prospective buyers and the credit terms offered by its competitors for a firm to be able to establish a sound credit policy. In establishing a sound policy on trade debtors management, management should consider cash discount, length of credit period, credit worthiness of the customers and action to be taken regarding late payment. Trade credit is an important source of short term financing. The longer the credit period obtained from suppliers, the less the amount of working capital required.

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