SMALL SCALE BUSINESSES PRACTICE OF BASIC FINANCIAL MANAGEMENT WITH REGARDS TO LIQUIDITY

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ABSTRACT

Effective working capital management is an integral part of every organization and most small scale enterprises find it difficult to achieve this.

The main objective of the study is to access the working capital management of small scale businesses and its impact on the survival and growth of the businesses. Based on this, the researcher used the small scale entrepreneurs who have been supported by Vocational Training for Females’ (VTF) programme as a case study.

Out of the six hundred (600) female entrepreneurs, sixty (60) of them were sampled for the study. Questionnaires and interviews were used to collect data for the analysis.

The findings revealed that most small scale businesses do not keep proper financial records, do not effectively manage their inventory and payables. They however saw the need for effective cash and receivable management. Small scale business again face the challenge of late payment by customers leading to bad debts, frequent changes in prices of goods, cash pile up in stock because of its slow movement.

Effective working capital management is critical for small scale entrepreneurs. Government and other stakeholders should collaborate to continuously support these business through workshops, seminar, trainings, to enlighten them on the necessity for managing working capital effectively and efficiently.

Key Words: Liquidity, Working capital, Management and Business

1.1 INTRODUCTION

"Cash is the lifeblood of business" is an often repeated maxim amongst financial manager. The rapid growth in most businesses has challenged the financial managers creativity to source for adequate financing. This rapid growth (expanded sales) may put an intense pressure on cash resources since money is needed for instance to purchase more inventories, pay suppliers among others. A large number of business failures have been due to the inability of the financial managers to properly plan and control their current assets and current liabilities within their organizations (Smith, 1973). A company can be more liquid if pragmatic measures or decisions are taken to achieve balanced or optimal working capital components. Most companies across the globe have been successful due to their much attention on how the day-to-day transactions or obligations are met effectively and efficiently. They focus mostly on the management of receivables, payables, inventories, and cash balances effectively.

Maximization of shareholder’s wealth is one of the basic objectives of financial management. Shareholder’s wealth can be maximized when sufficient income is made at the end of the period and the rapid growth in sales will result in large profits. However, funds are needed to purchase the raw materials, pay expenses, among others to sustain the business activities since these sales cannot be converted into cash immediately. The funds needed to run the day-to-day operational activities for sustainable growth is the working capital. Working capital therefore implies the net investment in short term assets (Atrill, 2006). An optimal level of working capital (a balance between risk and efficiency) needs continuous monitoring to maintain the optimal level of the various working capital components (Afza and Nazir 2009).

A working capital is the cash available for the transaction of day to day activities and also for unplanned or unexpected expenses within the organization. Working capital management therefore refers to the management of short-term assets against
the short-term liabilities. Efficient working capital management involves the planning and controlling of short-term assets and short-term liabilities in order to avoid excessive investments as well as eliminating the risk of not meeting the short-term obligations (Raheman & Nasr, 2007). An efficient working capital management will help build the enterprise and secures the financial stature of the enterprise. Although internal and other external factors may contribute to the success or failure of a business, an efficient and effective working capital management also plays an important role for the company (Pandachi, 2006).

1.2 STATEMENT OF PROBLEM
Effective working capital management is an integral part of every organization and most small scale enterprises find it difficult to achieve these optimal working capital components. Their inability to control the movement of day to day transactions to meet their short term needs have made most of them collapsed.

Generally, a good working capital policy should be well balanced to give a clear policy concerning the working capital components. For instance, the optimal level of accounts receivables should be used as a means of stimulating sales and other income. These sometimes do not happen in most organizations. According to Peterson and Rajan (1997), a negative association arises when the level of working capital is linked with operational performance as measured by operational returns and margins. Most organizations have little reason to hold an optimal working capital and would rather increase the level of operating assets and increase the need for external funding. The end result would be a lower return on equity as well as asset without any increase in profit.

According to International Finance Corporation (IFC) report on women entrepreneurs (2007), about 50.2% of the Ghanaian population is women and they make significant contribution to the economy growth. Most of these economically active women operate in the informal sector and they make about half of the entire labour force. According to the report, these women operate in the micro and small scale business. The researcher therefore focuses on the Vocational Training for Females’ (VTF) Programme beneficiaries as to establish the extent, to which the working capital management is practiced, the factors influencing working capital performance, the limitations to the practice of working capital and the impact on their survival.

1.3 OBJECTIVE OF THE STUDY
The main objective of the study is to access the working capital management of small scale businesses and its impact on the survival and growth of the businesses. Specific objectives are:

1. To analyze the extent to which small scale financial management practices affect the business survival

1.4 RESEARCH QUESTION
• How do small scale businesses practice basic financial management with regards to liquidity?

2.1 WORKING CAPITAL MANAGEMENT
2.1.1 Definition of working capital
According to Brigham and Gapenski (1996), the term working capital originated from an old Yankee peddler. This man would load up goods in his wagon with his horse and sell them for profit. To Brigham and Gapenski, the trade was financed by equity capital since he owned the wagon and the horse. He however borrowed money to purchase the goods. The merchandise was termed working capital whilst the money borrowed from bank was called working capital loan. It is therefore necessary for efficient management of working capital in small and medium enterprises than larger organizations since they might not get access to financial expertise like the large companies (Peel and Wilson 1994).

The term working capital is commonly used for the cash available in transacting day-to-day business activities such as; purchasing raw material, payment of salaries and wages, rents, among others. However, there is disparity among various financial authorities (Financiers, accountants, businessmen and economists) as to the exact meaning of term working capital. According to Brigham and Gapenski (1996), working capital is the portion of the businesses’ total financial resources which is put to a variable operative purpose.

Kirkman (1997) argues that although working capital is being considered as the difference between current assets and current liabilities with regard to the financial position of an organization; the precise definition has generated various arguments over the years. To him, net working capital (difference between current assets and current liabilities) indicates the liquidity of the firms and the extent to which working needs may be financed by permanent sources of funds.
Srinivas (1999) also defined working capital as the funds invested in current assets (inventory, cash, receivables, loans and advances) needed for the operational activities of the business. These current assets are essential for smooth business operations and proper utilization of fixed assets.

On the other hand, the term working capital is often referred to “circulating capital” which is frequently used to denote those assets which are changed with relative speed from one form to another. For instance, cash is changed for raw materials; raw materials converted into work-in-progress and finally to finished products; sale of finished products and ending with realization of cash from debtors (Brigham and Weston, 1977).

To Atrill (2006), working capital is a net investment in short term assets. These assets are essential for day-to-day operational activities of the business.

Khan and Jain, (2007) used the concept of working capital to define what working capital is. He argued that there are two concepts of working capital (Gross and Net). Gross working capital (GWC) which is also referred to as working capital is the total current assets of a business. The net working capital (NWC) on the other hand can be defined as the difference between current assets and current liabilities or; that portion of current assets which is financed with long-term funds.

Net working capital (NWC) technically, is the difference between current assets and current liabilities, whilst Gross Working Capital (GWC) refers to the sum of all current assets. Gross working capital is primarily quantitative in nature whilst net working capital is qualitative (Srinivas, 1999).

In light of the above definition and concept reviewed, the key components of working capital involve current assets and current liabilities. Smith (1980) stated that working capital management is the administration of the whole aspects of current assets and current liabilities. To Weston and Brigham (1977), working capital management is concerned with the problems that arise in attempting to manage the current asset and current liabilities as well as the interrelationship that exists between them.

**2.2 WORKING CAPITAL MANAGEMENT VRS LIQUIDITY AND PROFITABILITY**

The success of businesses mostly depends on how efficient the short term and current liabilities are managed on daily basis. Firms have glowing long term prospects and healthy bottom due to a good liquidity management.

The survival of every business depends mostly on its efficient working capital management. Efficient working capital management involves the planning and controlling of short-term assets and short-term liabilities in order to avoid excessive investments as well as eliminating the risk of not meeting the short-term obligations (Nasr, 2007). An efficient working capital management will help build the enterprise and secures the financial stature of the enterprise. Although internal and external factors may contribute to the success or failure of a business, an efficient and effective working capital management also plays an important role for the company (Pandachi, 2006).

According to Pandachi, achieving desired trade-off between liquidity and profitability becomes a problem for business owners especially when it comes to the maximization of a firm’s value. A firm is therefore expected to conduct its day to day activities in such a way that the optimal balance between liquidity and profitability is maintained.

Effective and efficient working capital management is necessary for the survival of small scale businesses. An inefficient working capital management results in funds being tied up in idle assets and thereby reducing the liquidity and profitability of the company (Kameswari and Reddy, 2004).

Smith and Begemann’s (1997) results also proved that the size of the business has an impact on the amount of working capital management. This was revealed when they examined the relationship between profitability and liquidity of South African companies.

Walt (2009) is of the view that both profitability and liquidity are equally important. To him Liquidity is more important because immediate survival of a firm depends on how liquid it is. However, it does not necessary mean that the company is profitable. It means that both measures can give the true picture of the company’s ability to survive or not.

According to Ali Uyar (2009), liquidity management is vital for a going concern in addition to profitability. The optimal liquidity position is necessary for business operations. This will enable business owners to deploy resources for the management of working capital.

Ganesand (2007) argued that firm’s free cash flow is increased when there is an efficient working capital.
This will lead to business growth as well as shareholders wealth maximization.

In examining the relationship between liquidity and profitability among Saudi Arabian firms (929 companies), using the correlation and regression analysis, Eljelly (2004) found out that the cash conversion cycle has an important measure of liquidity than the current ratio that affects profitability. From his conclusion, the impact on firm’s profitability depends significantly on its size of working capital.

Soenen (1993) also found a negative relationship between the return on assets and the length of net trade cycle using the chi-square as a measuring tool. He used the net trade cycle to measure the return on investment and working capital of US companies. Soenen was quick to add that, this relation will differ from one industry to another.

According to Jose et al (1996), there is also a significant negative relationship between the Cash conversion cycle and profits. Their results confirmed that aggressive working capital management results in a higher profit. Jose et al (1996) were examining the relationship between profitability and aggressive working capital management among US companies. Cash conversion cycle was used as measure of working capital management.

McMenamin (1999) stated that efficient working capital requires constant credit performance update and also sound criteria to develop credit extensions. Credit management becomes efficient when a firm is able to carry sufficient stocks as well as pay its bills on time.

Investing in working capital management has its costs and benefits. Carrying cost and shortage costs for instance should be reduced to the minimum level of current assets. There is therefore the need to strike an optimal level between the costs and benefits of current assets Brealey et al (2004).

According to Lyroudi and Tryfonidis (2006), there is a significant relationship between the traditional liquidity measures of current and quick ratios, and cash conversion cycle. They used the food industry in Greek to determine the relationship between the liquidity ratios and its component variables. The cash conversion cycle was used as a liquidity indicator. The cash conversion cycle had no relation with the leverage ratio but had positive relation with net profit and return on assets. They concluded that both large firms and small ones have the same liquidity ratios. There is no difference between them.

3.1 POPULATION

Population in this study refers to the number of small scale businesses to which the study is concerned. To Hungler and Polit (1999), it is the totality or aggregate of all the objects, subjects or members, subjects or objects that conform to a set of specifications. The population for the study was centered on small scale businesses to which one can generalize the result of the study. The research population was small scale business women have been trained and gained support from Vocational Training for Females’ (VTF) Programme. The total population was six hundred (600) small scale business women from which the sample was drawn.

3.2 SAMPLE AND SAMPLING PROCEDURE

The sample size was 60 out of the 600 women entrepreneurs supported by VTF programme (from 2007 to 2012) and also reside within Accra Metropolis. These small scale business women dealt in dressmaking, hairdressing, batik tye and dye, beads making, and catering as follows:

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<th>Trade</th>
<th>Total number of women supported by VTF</th>
<th>Number sampled for the study</th>
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<tr>
<td>Hairdressing</td>
<td>190</td>
<td>19</td>
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<tr>
<td>Dressmaking</td>
<td>340</td>
<td>34</td>
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<tr>
<td>Catering</td>
<td>40</td>
<td>4</td>
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<tr>
<td>Batik,Tye &amp; Dye</td>
<td>30</td>
<td>3</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>600</strong></td>
<td><strong>60</strong></td>
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This enables the researcher to get a fair assessment of the research work. To Hungler and Polit (1999), it was more economical to choose a sample of 60 small scale businesses that have passed through VTF programmes instead of studying the entire population of 600 small scale businesses. Obtaining data from the entire population would have been very difficult because of cost involve and the relocation of most of these business women. A simple random sampling was used in order to simplify investigations. In this random sampling, each of the small businesses had the equal chance of being selected because of the nature of job. It helped to
reduce cost and at the same time retains almost the same degree of accuracy. Conclusion was used to represent the sample size in bringing out the true reflection of the research work.

3.3 RESEARCH TECHNIQUES/INSTRUMENTS

In the search for relevant information for the study, structured questionnaires were used for as the research instrument. The questionnaire was designed to gather information about small scale business’ knowledge and understanding regarding the need for efficient working capital management practice. It was also structured in a simple language for the respondents to easily understand.

The questionnaire was divided into two parts (part 1 and part 2). The part one dealt with the personal and general information (10 questions were asked). The part 2 dealt with the information about working capital management.

The questionnaire was to understand how small scale businesses effectively practice their working capital. It was based on similar research instruments and the set objectives of the study. For the purpose of reliability and validity, the research instrument was pretested before its administration.

To Mark (2003), valid and reliable data that are relevant to a research questions are useful to the study especially when qualitative interviews are used. The interview was analysed based on the notes made when the one-on-one interview was done especially with those who were unable to read. This helped the researcher to understand the reasons for their opinions and attitudes toward working capital management. It also enabled the researcher to have a fair idea about the current situations of the business environment.

Aside the questionnaire and interviews, the researcher used secondary data from books, journals, internets, newsletters, reports from VTF Programme and similar research works pertaining to working capital management.

3.4 DATA ANALYSIS

The researcher used the data obtained from the questionnaire to analyse the performance in relation to working capital. This analysis was done to know how effective small scale businesses practice working capital management with respect to liquidity and profitability. The data obtained were presented and analysed using tables and charts. Ratios relating to working capital management were not used because of the researcher’s inability to have access to the financial statements of these small scale businesses.

For consistency of responses from the questionnaire, the data collected from the field were manually screened before entering them to the computer. The researcher used statistical data such as Statistical Package for Social Science (SPSS) software and Microsoft Excel for the analysis. These were used because they allow for clarity and easy understanding of the data.

4.1 RESULTS OF RESEARCH QUESTION

The research question examined the extent to which basic financial management practices affects the business’s survival in terms of financial records keeping, saving culture, access to business loan for expansion, source of capital and computer usage to enhance progress of work. Respondents were given options about, for instance, the book they use for recordings, where they got capital to start their businesses and if it was to be loan then, what were some of the problems they encountered. They were also questioned about the need for saving or investing for future expansion as well as being liquid for unforeseen obligations.

With the type of financial records these small business entrepreneurs keep, about thirty-three percent (33.3%) of the respondents don’t keep any of the financial books recording the highest, followed by twenty-eight percent (28.3%) respondents who use the cash book. More than twenty-six percent (26.7%) use the sales day book while about two percent (1.7%) and two percent (1.7%) use the debtor’s day book and creditor’s day book respectively. For those who keep these books, more than thirty-three percent (33.3%) do the recordings every day, more than twenty-one percent (21.7%) sometimes do it, followed by eight percent (8.3%) of participants who do the recordings twice a week and five percent (5%) rarely make financial recordings. Obviously those who do not use financial records had never made any recordings and that accounted to more than thirty-one percent (31.7%).

Almost all the respondents who participated in this study have not used computer before and let alone using it to run their business activities. The research revealed that out of the sixty (60) small scale business women sampled, ninety-five percent (95%) of them do not use computers for their business operations. Only five percent (5%) make use of them to run their day to day transactions.
The availability and easy access to funds is necessary for smooth running of businesses. On the saving culture of these business owners, more than eight percent (8.3%) do not save at all but the rest have various financial institutions that they save. More than forty-eight percent (48.3%) save with the banking institutions, more than twenty-eight percent (28.3%) save with the micro-finance institutions, and eight percent (8.3%) save with the rural banks whilst almost two percent (1.7%) saves with the susu collectors. Their reason for saving varies from one business owner to another. More than thirty-six percent (36.4%) save to monitor the growth of their businesses recording the highest among them. The second highest was about thirty-one percent (30.9%) who said they wanted to separate the business money from their personal money. Twenty percent (20%) want to use it to invest in equipment (purchase new machines and container) while more than seven percent (7.3%) use it to access loan from banks. Some debtors may pay their debt with cheque and therefore about four percent (3.6%) save to facilitate debt collection whilst almost two percent (1.8%) wants to pay their suppliers through the bank and therefore need to save with these financial institutions.

Business operation and its management need a minimum capital to start with and getting these funds also varies from one organization to another. The research revealed that about seventy-three percent (73.3%) of small scale business owners operate the business with their own money making the highest score among them. The second highest which is more than thirteen percent (13.7%) took their funds from relatives whilst about seven percent (6.7%) get theirs from the financial institutions. Five percent (5.0%) had their start-up capital from friends while about two percent (1.7%) inherited it from family.

Participants were also asked about the processes they pass through before getting access to loan from the financial institutions. About fifty-two percent (51.7%) had it easy in getting credit whilst forty percent (40%) found it difficult. Whilst about seven percent (7%) were finding it very difficult to access loan about two percent (1.7%) found it very easy.

Those who found it very difficult and difficult in accessing loan complained about some cumbersome requirements before credit was given. More than thirty-eight percent (38.3%) complained about collateral security which was been required by the financial institutions whilst others talked about high interest rate (16.7%). Those who requested for financial report accounted for about twelve percent (11.7%). More than thirty-three percent of the participants said that there were no requirements in their quest for micro credit and that made it easy for them. The table 4.2 below shows the summary of the findings.

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<th>Table 4.2: Financial Information of Participants</th>
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4.2 DISCUSSIONS OF RESULTS

Good financial record keeping, proper savings culture for future, reliable source of funds among others affects the liquidity of small scale businesses. The results revealed that only twenty-eight percent (28.3%) and twenty-seven percent (26.7%) keep cash book and sales book respectively for financial records. About thirty-three percent (33.3%) out of the sample size (60) do not keep any records at all. This could be due to their financial illiteracy. They also think that the business is their own and do not account to anybody and therefore they manage their businesses as how it pleases them. Although we see about sixty-seven percent (67%) of the participants keeping various type of records (cash, purchase, sales, creditors and debtor’s books), none of them keep all the books. They keep books which they are familiar with and even these records are not kept regularly. Because of this they easily forget the value of their products and other transactions. At the end of the day, the business would run out of cash for daily transactions leading to the collapse of the business. This affirms the work of Marfo-Yiadom’s (2002) assertion that, proper records keeping would improve working capital of small scale businesses leading to profitability.

Small scale businesses have different reasons for saving. The findings revealed how the small scale entrepreneurs’ appreciate the need to save at trusted financial institutions (bank = 48%, Micro-finance = 28%). There were few (8%) who do not save and this could be the difficulty in getting their money back, not having enough cash to save, or reinvest into the business. Monitoring the growth of business (36.4%), separate business from personal activities (30%); invest in equipment (20%), access to loan (7.3%) were some of the reasons why they save. This is a good approach since small scale business should also be liquid for precautionary and transactional motive (Keynes, 1973).

According to Buame (1996), one of the problems small scale businesses in Ghana face is the adequate start-up capital and it was not surprising when the results revealed the same thing. Seventy-three percent (73%) of the participants used their own funds to start the business, some from relatives (13.3%) and so on. Loan from financial institutions were very few at seven percent (6.7%) because forty percent (40%) of these participants found it difficult to access credit. Most financial institutions request for some requirement before loan was given. It was revealed from the findings that, collateral security (38%) was the main challenge followed by high interest rate (16.7%) and financial report (11.7%). This confirms liedhom and Mead, (1986) observations that access to credit from financial institutions serves as one of the main challenges.

However, fifty-two percent (51.7) of the participants found it easy in accessing loan and there were no cumbersome procedures before loan was given. The reason was that VTF Programme has instituted a micro credit solely for its member groups with a minimal interest below the market rate. With this no collateral or other charges are imposed on the loan compared with the financial institutions.

5.1 FINDINGS

The results of the research question revealed that

- Thirty three percent (33.3%) of the small scale businesses do not have the requisite skill in keeping proper financial records

- The use computer in business transactions were not part of small scale businesses. Only five percent (5%) use computer
92% of respondents saw the importance of saving and therefore save with trusted financial institutions. They save mostly to monitor the growth of their businesses.

Lack of collateral security requested by credit providers makes the small scale business unable to access loan. Only thirty-three percent (33%) of the financial institutions do not collect collateral.

VTF Programme provides micro credit to its members at a reduced interest rate and without collateral. This makes it easy for some of them to have access to micro loans.

Seventy-three percent (73%) of the small scale businesses start the business with their own limited money.

5.2 CONCLUSION

The findings from this research area concluded that effective working capital management is not practiced by the small scale businesses. One of the research objectives was to analyze the extent to which small scale business manage their finances with regards to business survival. These sixty (60) participants who have been trained by VTF Programme have a little knowledge in financial management in terms of record keeping, savings for the business, financing their business, among others; but practicing it regularly is the problem. These entrepreneurs may find it difficult to trace their money especially when they encounter transactional problems with the financial institutions (banks may ask for advice slips). This confirms Marfo-Yiadom’s (2002) assertion that effective financial management (proper records keeping) would help them appreciate the difference between working capital and profit leading to business survival.

5.3 RECOMMENDATION

Based on the research findings and conclusions from the study, the following recommendations were suggested:

- Customers’ creditworthiness should be assessed before credit is given. Small scale businesses should for instance should assess the risk or cost of maintaining credit customers with their returns to the business. If it will cause any liquidity problem, credit should not be given. A clear debt collection procedures should therefore be maintained.

- If debt collection from customers is becoming difficult to deal with, factoring would be another option. They should however bear in mind the cost associated with it.

- Effective inventory technique should be applied by small scale businesses. Goods should be purchased as and when needed and also take advantage of discounts to make bulk purchases.

6.1 REFERENCES


