

**THE EFFECT OF WORKING CAPITAL MANAGEMENT
(A CASE STUDY OF SMALL AND MEDIUM ENTERPRISES IN KUMASI).**

BY

DAVID OSEI TUFFOUR

ANTHONY BOAKYE APPIAGYEI

JULIET ACHIAA GYASI

ELIZABETH ANOKYE

ROSEMARY ASANTE

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DECLARATION

We declare that, except for references to other people’s work, which has been duly acknowledged, this work is the result of the groups own research and that it has neither in part nor whole been presented elsewhere for another degree. We Also Declare That We Have Been Under Supervision For This Report Herein Submitted.

Name/ID	Index Number	Signature	Date
David Osei Tuffour	10259107	.....	.....
Anthony Boakye Appiagyei	10135325	.....	.....
Juliet Achiaa Gyasi	10124168	.....	.....
Elizabeth Anokye	10135231	.....	.....
Rosemary Asante	10135232	.....	.....

Supervisor’s Declaration

I Hereby Declare that the Preparation and Presentation of the Dissertation Were Supervised In Accordance With the Guidelines on Supervision Laid Down By Christian Service University College

Supervisor	Signature	Date
Ben. Agyei-Mensah (Dr.)

Head of Department

Kwaku Ahenkora (Dr.)
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ABSTRACT

The main thrust of this study is to unveil the working capital management practices of Small and Medium Enterprises (SMEs) in the Ashanti Region of Ghana. The study used descriptive statistics for the presentation and analysis of findings. The results show that 16 percent of SMEs receive credits from their suppliers and the average credit period range between two weeks to one month. On the other hand, the credit period given by SMEs to their credit customers range is less than months.

From the study, two main problems faced by SMEs in dealing with credit customers are late payment and bad debt. The results show that 50 percent of respondents use note books while only 0.7 percent uses computers for inventory control. Fifty-seven (57) percent of the respondents had bank account for their businesses. Personal savings accounted for about 38 percent of start-up capital and SMEs consider inflation/price increases to be more problematic than even higher debtors turnover period and low stock turnover. Consequently, it is recommended that there should greater collaboration between the Business Advisory Centres (BACs) and the various associations of SMEs for the financial training of entrepreneurs. Government will have to expand the BACs currently located in only the district and regional capitals. The National Board for Small Scale Industries (NBSSI) should design and print more simplified record keeping document, like their current cash book, for use by the SMEs. The SMEs should use their association in a co-operative manner to procure inventory.

Key words: Working capital management, inventory, cash, accounts receivable, Accounts payable, Ashanti region, Ghana.

DEDICATION

This piece of academic work is dedicated to the almighty God for his guidance and protection throughout the undertaken of this project work.

It is also dedicated to our loved ones especially to our parents and spouses for their moral, prayers and financial support.

Our lectures and all those who contributed in one way or another to make this work a success.

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CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND

Historically, working capital management has passed through different stages, mainly – the control, optimization and value measurement. Working capital management originally started as a systematic approach of controlling the incoming, outgoing and remaining balances of cash, receivables and inventories. At this stage the main objective is that working capital is not misappropriated for personal benefits of those who are entrusted with its management. To this end both researchers and practitioners developed various control measures over the receipts and collections of cash, receipts and issuance of inventories as well as the increase of receivables through credit sales and decrease of receivables through cash collection.

Under the optimality management phase, the main focus was not only on the physical safety of working capital items but also on the minimization of related costs and maximization of related income. Under the control and optimality approaches the amount of accounting profit is taken as a main measure of managerial efficiency.

Under the value measurement approach working capital management concentrated on how to help managers in the creation and measurement of value without disregarding the above two objectives. Particularly, the cash flows approach is used as a main tool to measure the value created by firms. The control, optimality and value measurement approaches more or less concentrate on the internal management of working capital. In our study, we introduce a new dimension to these approaches – the external management of working capital. We argue that to have a maximum impact on value, firms should manage working capital in co-operation with their backward linkages (suppliers) and forward linkages (customers). By doing so firms

can internally minimise the costs of the levels of working capital investment and short-term financing and externally minimise the costs of inter-firm transactional relations and thereby create more value.

Important theoretical developments in finance during the past decade have provided the potential for improved decisions in business organisations. Unfortunately, developments have not been uniform across all areas of financial decision making within and between business organisations. Working capital appears to have been relatively neglected in spite of the fact that a high proportion of the business failures is due to poor decisions concerning the working capital of the firms (Smith 1980a). Of interest in this book is therefore the area of intra and inter-firm working capital management, which generally encompasses short-term investment and financing decisions of firms.

In a perfect world, working capital assets and liabilities would not be necessary because there would be no uncertainty, no transaction costs, and no scheduling costs of production or constraints of technology. The unit costs of producing goods will not change with the amount produced. Firms would borrow and lend at the same interest rate. Capital, labour and product markets would reflect all available information and would be perfectly competitive.

In such an ideal business world there would be little need to hold any form of inventory other than a limited amount of goods in process during production. But such an ideal business assumes that demand is exactly known in advance, that suppliers keep to their due dates, production can be smoothed and orders executed directly without costs and delays. There would be no need of holding cash for working capital other than for the initial costs, because it could be possible to make the payment from every receipt of sales. There would also be no

need for receivables and payables if customers pay cash immediately and the firm would also make its payments promptly.

However, problems of working capital exist because these ideal assumptions are never realistic and therefore working capital levels make a significant part of a firm's investment in assets and these assets have to be financed implying that investments may have benefits as well as costs. Working capital investments and related short-term finances originate from three main business operations - purchasing, producing and selling. They can be considered as consequences of business operations. However, as much as the operations affect the balances of working capital investments and finances, the latter also determine the cost and flexibility with which the operations are performed. Efficient management of working capital investments and related short-term debts can be used to make the purchasing, producing and selling operations cheaper and more flexible. In the latter sense they are used as instruments for the management of business operations, which in the meantime create benefits and costs. Therefore, the relevance of working capital investments and short-term debts originate from these benefits and costs. Beyond doubt efficient management of both items can help the success of firms in generating value. Operations are results of inter-firm transactions. Therefore, managing working capital investments, finances and operations internally within firms and the efficiency with which firms co-operate among themselves determine their end result.

Evidence has shown that small and medium enterprises (SMEs) in Ghana over the years have contributed greatly to the overall employment and production of goods and services. According to Abor and Quartey (2010), small and medium enterprises provide 85 per cent of

manufacturing employment, contributes about 70 per cent to Ghana's Gross Domestic Product and account for about 92 per cent of businesses in Ghana.

SMEs being a "key source of dynamism, innovation and flexibility in advanced industrialised countries, as well as in emerging and developing economies", their well-being and continuity are crucial to the macroeconomic development of any country around the globe.

The importance of finance in promoting the growth of small business has been acknowledged in prior studies on small business growth and development (Abor and Biekpe, 2006, Kasekende, 2001). Other studies have identified finance as the most important constraint to growth in the small business sector (Aryeetey *et al*, 1994; Steel and Webster, 1992 and Sowa *et al*, 1992). Mead and Liedholm (1998) in their study of the problems of small business in Africa identified lack of demand and shortage of working capital as the main reasons for small business closures in Africa

1.2 STATEMENT OF THE PROBLEM

The Problem statement to be analysed in this study is, "Does efficient working capital management enhance the operations of SME's in Kumasi – Ghana?"

1.3 OBJECTIVES OF THE STUDY

The main objectives of the study are:

- To evaluate other method of debt payments than payment out of cash.
- To evaluate or establish an optimal working capital cycle that will encourage payment of debtor using short term sources of fund.

- To study the extent to which working capital management is being practiced in small and medium enterprises
- To find out the limitations and shortfalls being faced in the practice of working capital management in SME's
- To establish the importance of working capital management in SME's
- To make relevant recommendation based on the findings that will enhance the efficient practice of working capital management

1.4 RESEARCH QUESTIONS

- What are other methods of debt payments than payment out of cash?
- What optimal working capital cycle that will encourage payment of debtor using short term sources of fund?
- To what extent is working capital management is being practiced in small and medium enterprises?
- What are the limitations and shortfalls being faced in the practice of working capital management in SME's?
- Is working capital management in SME's important?

1.5 METHODOLOGY

The study on working capital management practices was descriptive cross sectional survey, to find out how the enterprises sampled were managing their working capital and to evaluate the practices.

It was difficult to obtain the population of small scale enterprises in the Ashanti Region. In the absence of credible database, the firms included in the study were enterprises whose

owners have attended training programmes of the Business Advisory Centres (BACs) of the National Board for Small Scale Industries (NBSSI) or belong to associations such as the Ghana hairdressers and beautician and Ghana Tailors and Dressmakers Associations in six towns. The principal factor that influenced the selection of the six towns was their commercial nature. This study was conducted in Kumasi, Ashanti Region, Ghana. We focused on working capital management practices and its effects on the day – to – days or operations of the small and medium enterprises (SME's)

Data used include journals, reports, books, current information from the internet, websites, our constructed questionnaires and interviewing. The study also include data of the number of days of accounts receivables, number of days of accounts payable, numbers of days of inventories , operational cycle.

The study looked at the issue of identifying key ratios that influence working capital management. Our choice of the ratios is influenced by the previous studies on working capital management and profitability by Abdul Raheman and Mohamed Nasr, international review of business research papers, vol.3 no 1 march 2007 pp. 278 – 300

1.6 THEORETICAL AND EMPIRICAL FRAMEWORK

Working capital is usually defined as current assets less current liabilities. The major elements of current assets are inventories, accounts receivables and cash (in hand and at bank) while that of current liabilities are accounts payable and bank overdrafts. According to Atrill (2006), working capital represents a net investment in short term assets. These assets are continually flowing (circulating) into and out of the business, are essential for day-to-day operations. The various elements of working capital are interrelated, and can be seen as part of a cycle. From Cash is used to pay suppliers when raw materials are obtained on credit or

raw materials are bought with cash, the raw materials are turned into finished goods which are either sold for cash or credit. Credit sales create account receivables which are subsequently collected as cash.

Among the various factors which influence working capital policies of firms include nature of business, market/ demand conditions ((Ben-Horim and Levy,1983), Technology and manufacturing policy (Wood, 1993), credit policy of the firm (Walia, 1977), payable management (Gitman, 2005) operating efficiency (Abdul Rahman and Mohamed Ali, 2006; (Fairchild, 2005), (Sehgal, *et al*, 2006) (Hossain and Akon, 1997)), competition (Filbeck and Krueger, 2005), conditions of supply, size, agency problem, growth and profitability, (Kolay, 1991) industry (Hawawini, *et al*,1986; and Nunn (1981)). Marfo-Yiadom (1996) concluded that nature and size of business, business fluctuation, growth and expansion activities, availability of credit facilities from suppliers, and price level changes influence working capital decisions greatly. Moyer et al (2001) considered sales level, credit policies and the length of the operating cycle.

The extant literature reveals the components of working capital as consisting of current assets less current liabilities. The working capital is affected by a number of factors including the nature of the business, credit policy, conditions of supply, price level changes.

1.7 JUSTIFICATION FOR THE STUDY

The significance of the research is to know how to effectively and efficiently manage working capital. The final research finding will give management the opportunity to have an in – depth understanding of working capital management and their applications and also to rethink their working capital management strategies. Since SME's normally have problems

getting external finance, proper working capital management can help reduce over reliance on external finance. It could also be a blueprint for policy makers and regulators to help shape the debate on working capital management and guide policy direction. For academic purpose, this study seeks to add to already existing knowledge in this area.

1.8 SCOPE OF THE STUDY

The geographical scope for the study is Kumasi, the capital of the Ashanti region of Ghana. The region was chosen because of convenience to the researchers in obtaining the necessary responses for the study. The study therefore involves selected SME's in this area. In terms of content, the study focuses on assessing the impact of working capital management on the performance, profitability, market share and other critical issues like survival, risk, growth etc. of SME's in the Kumasi metropolis.

1.9 LIMITATION OF THE STUDY

The limitation of this study was the gaining our hands on the financial statement of the selected SME's. Secondary limitations included financial constraints as well as the inadequacy of the allotted time in which the project is to be completed.

The aforementioned were limitations in the sense that availability of resource such as time and funds would increase the depths of knowledge this study can attain. In addition to this, there was a problem of high illiteracy level among the managers and owners of the selected venture

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

Working capital refers to the cash a business requires for day-to-day operations, or, more specifically, for financing the conversion of raw materials into finished goods, which the company sells for revenue. Working capital management for financing Small and Medium-Scale Enterprises is not only very important for SMEs, but also important for financial institutions, the Government and all other stakeholders in the SME subsector. This paper seeks to identify and highlight the management of the components of working capital to internally generate funds to finance the activities and operations of SMEs in Kumasi and Ghana as a whole which serves as a constraints to the development of the sector. The paper was structured after considering few previous studies on the subject under consideration.

2.2 DEFINITIONS OF SMEs

Available data from the Registrar General indicates that 90% of companies registered are micro, small and medium enterprises. This target group has been identified as the catalyst for the economic growth of the country as they are a major source of income and employment. Data on this group is however not readily available.

SME's stands for Small and Medium Enterprises also called Small and Medium-sized Enterprises. These are companies whose headcount or turnover falls within certain limits. However, what exactly an SME or Small to Medium Enterprise is, depends on who is defining since no single, uniformly acceptable definition of SME's exist. They are mainly defined along the lines of number of employees, turnover, profitability, net worth, etc.

Bank of Ghana guideline to commercial banks on how to classify their customers also defines SME's: employees should not exceed 50 and their turnover/ assets should not exceed \$10,000,000 (source: The Trust Bank, Ghana).

UNIDO's Defines SME's in Developing Countries as Medium - firms with 20 - 99 workers, Small 5 - 19 workers and for Industrialised Countries - Medium - firms with 100 - 499 workers and Small ≤ 99 workers.

Also, the National Board of Small Scale Industries (NBSSI) in Ghana defines a Small Scale Enterprise as one with not more than 9 workers, has plant and machinery (excluding land, buildings and vehicles) not exceeding 10 million Cedis. The Ghana Enterprise Development Commission (GEDC) on the other hand uses a 10 million Cedis upper limit definition for plant and machinery.

Defining what SMEs are remains to be inconclusive and unsettled globally as even the power nations like the US and strong international unions like the European Union are yet to achieve a uniform definition.

Generally, this target group, that is, SME's in Ghana is defined as:

Small Scale enterprises have been variously defined, but the most commonly used criterion is the number of employees of the enterprise. In applying this definition, confusion often arises in respect of the arbitrariness and cut off points used by the various official sources. As contained in its Industrial Statistics, The Ghana Statistical Service (GSS) considers firms with less than 10 employees as Small Scale Enterprises and their counterparts with more than 10

employees as Medium and Large-Sized Enterprises. Ironically, The GSS in its national accounts considered companies with up to 9 employees as Small and Medium Enterprises.

An alternate criteria used in defining small and medium enterprises is the value of fixed assets in the organisation. However, the National Board of Small Scale Industries (NBSSI) in Ghana applies both the 'fixed asset and number of employees' criteria. It defines a Small Scale Enterprise as one with not more than 9 workers, has plant and machinery (excluding land, buildings and vehicles) not exceeding 10 million Cedis (US\$ 9506, using 1994 exchange rate). The Ghana Enterprise Development Commission (GEDC) on the other hand uses a 10 million Cedis upper limit definition for plant and machinery. A point of caution is that the process of valuing fixed assets in it poses a problem. Secondly, the continuous depreciation in the exchange rate often makes such definitions out-dated. In the EU, a similar system is used to define Small to Medium Enterprises. A business with a headcount of fewer than 250 is classified as medium-sized; a business with a headcount of fewer than 50 is classified as small, and a business with a headcount of fewer than 10 is considered microbusiness. The European system also takes into account a business's turnover rate and its balance sheet.

The scope and role of financial manager in small and medium enterprises have been narrowed down to basic approaches as follows:

1. The traditional approach.
2. The managerial approach.
3. The new approach.

2.2.1 The Traditional Approach

According to this approach, the scope of the financial manager are confined to raising of funds (Kehinde and abiola, 2005), during major events (Such as promotion, recognition, expansion) in the life of the firm. The financial manager has the basic obligation of ensuring that the firm has enough cash to meet its obligations. A notable feature of the traditional approach on financial manager's duty is the assumption that the financial manager has no concern in the decision of allocating the firm's funds. The problem of the approach is that much emphasis is placed on long term financing to the detriment of working capital management.

2.2.2 The Managerial Approach

The change in the business situation in the mid-1950, made the traditional approach to outlive its usefulness. The increase in market, the population growth, the management efficiency and future, during and after the mid-1950s necessitated efficient and effective utilization of the firm's resources. Consequently, financial management approach and scope markedly changed. The emphasis shifted from episodic financing to the managerial financing functions from raising of funds to include efficient and effective use of funds. This approach includes profit planning function. The term profit planning refers to operating decisions in the area of pricing, volume of output and the firm's selection of productive assets.

2.2.3 New Approach

This approach derive it impetus from the Lord Keynes's general theory. The core of the new theory, as applied to the business finance is found in the macroeconomic concept that level of aggregate economic investment depends on two factors viz: The additional expected rate of return on investment (marginal efficiency of investment) (Anao, 1990; Charles, 1992).

Keynes defined marginal efficiency of capital as ratio between the prospective yield of additional capital goods and their supply price i.e.

$$E = Y$$

P

Where E = Marginal efficiency of capital

Y = the estimated yield of the capital asset

P = the supply price of the assets respectively or the original cost of investment.

The marginal efficiency of capital (e) is considered an important determinant of whether an entrepreneur should or should not take interest (r). The entrepreneur will optimize his profit if he continues to take up additional investment until $e = r$. basically, according to Geoffrey the function of the financial manager is to review and control decisions to commit or recommit funds to new or on-going uses. Thus, in addition to funds, financial manager is directly concerned with production, marketing and other enterprises activities whenever decisions are made about the acquisition or distribution of assets.

2.3 CHALLENGES FACED BY SME's (FINANCING)

Access to finance remained a dominant constraint to small and medium-scale enterprises in Ghana. Credit constraints pertaining to working capital and raw materials were cited by respondents (between 24% and 52% in Parker et al). Any potential provider of external debt or equity finance will want to monitor the SME's to determine whether it is acting in accord with the initial contract, to follow the progression of the firm and to have the means to oblige the user of funds to respect the interests of the provider of funds. There are numerous reasons why doing this effectively is more problematic for SMEs than for larger firms. Hence, banks are more likely to engage in credit rationing (i.e. not extending the full amount of credit

demanded, even when the borrower is willing to pay higher rates) to SMEs than to larger companies.

In the first place, the SME sector is characterised by wider clash of profitability and growth than larger enterprises. SMEs also exhibit greater year-to-year volatility in earnings. There is a perception of higher risk due to the fact that survival rate of SMEs is considerably lower than that of larger firms.

In the case of SMEs, it is very difficult to distinguish the financial situation of the firm from that of its owners. The use of company cars and home accommodations for both private and business purposes are clear cases in point.

The difficulty in gaining access to resources and financial markets is also largely to the fact that these SME's generally have inadequate or no collateral securities unlike the large firms. The few financial institutions, the Microfinance institutions that do give credit to SME's charge very high interest rates to make up for the high risk of granting credit to SME's.

Furthermore, the relations between the firm and its stakeholders are likely to reflect personal relationships to a much higher degree than in larger firms where such relationships are formalised. Whereas large firms are expected to observe recognised standards of corporate governance in which actors such as executives, auditors and boards of directors are expected to conform to transparent norms, SMEs tend to reflect much more closely the personalities of their owners.

There are also potential principal or agent problems. The provider of credit will seek to require the borrower to act so as to maximise the probability that the loan is repaid, while the

borrower may seek higher risk or higher return solutions. Once financing is received, the entrepreneur may be motivated to undertake excessively risky projects, since all of the upside of the project belongs to the entrepreneur, while the lender prefers a less risky project that increases the probability that the loan will be repaid. This problem, which is potentially present in all lending, is more serious for smaller firms to gain finance from formal sources such as banks.

There is also informational barrier. Asymmetric information is a more serious problem in SMEs than in larger firms. The entrepreneur has access to better information concerning the operation of the business and has considerable leeway in sharing such information with outsiders. However, the entrepreneur is also likely to have less training or experience in business than those in a larger company, although more adapted to operating in an uncertain environment. Hence, it may be difficult for the outside provider of financing to determine whether the entrepreneur is making erroneous decisions or for the outsider to understand the business adequately. As a result, SMEs often cannot obtain long-term finance in the form of debt and equity.

2.4 WHAT IS WORKING CAPITAL MANAGEMENT?

The working capital meets the short-term financial requirements of a business enterprise. It is a trading capital, not retained in the business in a particular form for longer than a year. The money invested in it changes form and substance during the normal course of business operations

Working capital refers to the cash a business requires for day-to-day operations, or, more specifically, for financing the conversion of raw materials into finished goods, which the

company sells for revenue. Among the most important items of working capital are levels of inventory, accounts receivable, and accounts payable. The better SME's manage their working capital, the lesser the need to borrow. Even companies with cash surpluses need to manage working capital to ensure that those surpluses are invested in ways that will generate suitably high returns for the business.

Implementing an effective working capital management system is an excellent way for many SME's to improve their earnings. The difficulty in gaining access to resources and financial markets is due largely to the fact that these SME's usually having little or no collateral securities. The few financial institutions, the Microfinance institutions that do give credit to SME's charge very high interest rates to make up for the high risk of granting credit to SME's them. This prompts entrepreneurs to look for other avenues to fund themselves and such include resorting to borrowing from friends and family, ploughing back profit, using their own savings among others to attain funds which are usually inadequate to fund their business operations and activities.

Due to the challenges SME's go through in securing funds to operate the activities of the firm, it will be prudent for them to effectively and efficiently manage the components of working capital to generate funds to support business operations.

2.4.1 Benefits of Working Capital Management

Not to overstate the obvious, but effective working capital management can free up cash and generate more earnings today. This is particularly important in tight credit markets like we have seen in recent years. A continuous improvement program focused on cash management,

accounts receivable performance and inventory management is part of fundamental business management.

The path to success is a disciplined approach that challenges management to improve the working capital metrics every day.

Working capital is particularly important for SME's. Firms can generate operational capital by minimizing their investment in fixed assets through the renting or leasing plant and equipment but they cannot avoid investment in cash, trade debtors and stock. However, the relationship between sales growth and the need to finance current assets is close and direct.

The objective of working capital management is to maintain the optimum balance for each of the working capital component. This includes making sure that funds are held as cash in banks deposits for as long as and in the largest amounts possible, thereby maximizing the interest earned. However, such cash may more appropriately be "invested" in other assets or in reducing other liabilities.

Each component of working capital (namely inventory, receivables and payables) has two dimensions TIME and MONEY (Thomas and Searberough,). If it comes to managing capital, Time is money. If you can get money to move faster around the cycle (e.g. collect monies due from debtors more quickly or credit sales), the business will generate more cash or it will need to borrow less money to fund working capital. As a consequence, you could reduce the cost of bank interest or you'll have additional free money available to support additional sales growth or investment. Moyer et al (2001) submit that effective cash management is particularly important for small firms for the following reasons:

- To prepare financial plans to support application for bank loans;
- Because of limited access to capital, a cash shortage problem is both difficult and more costly for a small firm to rectify than for a large firm;
- Many entrepreneurial firms are growing rapidly; they have a tendency to run out of cash. Growing sales require increases in inventories and accounts receivable thereby using up cash resources; and
- Entrepreneurial firms frequently operate with only a minimum of cash resources because of the high cost of, and limited access to, capital.

2.4.2 Factors Influencing and Hindering the Practice of Working Capital Management in SME's

Sound financial management plays a major role in the survival and growth of every business. In a research conducted on behalf of the Chartered Institute of Management Accountants (CIMA), Stuart McChlery et al (2004) identified some factors which act as a catalyst and barriers to sound financial management systems in SME's. The principal catalysts according to the findings are:

- Computerized accounting systems for periodic financial reporting
- Highly motivated owners or directors of firms
- Qualified internal accounting staff
- Proactive external accountants
- Pressure from providers of finance, including business angels.

Many of the factors identified by Stuart McChlery et al as a catalyst to sound financial management (including the application of working capital and capital hedging techniques) need to be tested empirically in a developing country like Ghana. The condition prevalent in developed countries like United Kingdom is basically different from that of the developing

country like Ghana. There is therefore the need to undertake a study in a less developed community like Kumasi. (Financial management practices and Working management practices Agyei-Mensah 2012)

Quite a significant number of those firms surveyed in Quebec were regarded as practicing sound financial management which included the application of working capital management and capital budgeting.

Moreover, there are data to affirm some of the findings identified by Stuart McChlery et al (2004) (Agyei-Mensah 2012) as a catalyst to the application of sound financial management. For example a progress has been made in encouraging small business owners and manager to install and use accounting information systems. Stuart McChlery et al (2004) (Agyei-Mensah, 2012), identified the following as barriers to the development of robust financial management systems

- The lack of internal accounting staff, where there were such staff but they were unqualified, untrained or unmotivated, which could act as a significant barrier to the development of sound management systems
- Some of the accountant of the firms engaged did not appear to add any value to, and appeared to lack an awareness of the needs of small businesses (SME's). Many firms expressed disappointment at the limited support and advice made available by some of their external accountants. Particularly, they perceived that they received little advice on development of their financial systems, especially management accounting aspects.
- Poor targeting and delivery of training and other support also acted as a disincentive to systems development.

Just like the catalysts identified by Stuart McChlery et al as catalysts to the application of sound financial management, the barriers to sound financial engagement application indicated above also need to be tested in a less developed country to make a better generalization of the Stuart McChlery et al (2004) findings.

All the above studies provide us a concrete base and give us idea regarding working capital management and its components. They also give us the results and conclusions of those researches already conducted on the same area for different countries and environment from different aspects. On basis of these researches done in different countries, we have developed our own methodology for research.

The working capital meets the short-term financial requirements of a business enterprise. It is a trading capital, not retained in the business in a particular form for longer than a year. The money invested in it changes form and substance during the normal course of business operations. The need for maintaining an adequate working capital can hardly be questioned. Just as circulation of blood is very necessary in the human body to maintain life, the flow of funds is very necessary to maintain business. If it becomes weak, the business can hardly prosper and survive. Working capital starvation is generally credited as a major cause if not the major cause of small business failure in many developed and developing countries (Rafuse, 2002). The success of a firm depends ultimately, on its ability to generate cash receipts in excess of disbursements. The cash flow problems of many small businesses are exacerbated by poor financial management and in particular the lack of planning cash requirements

While the performance levels of small businesses have traditionally been attributed to general managerial factors such as manufacturing, marketing and operations, working capital management may have a consequent impact on small business survival and growth (Kargar and Blumenthal, 2003). The management of working capital is important to the financial health of businesses of all sizes. The amounts invested in working capital are often high in proportion to the total assets employed and so it is vital that these amounts are used in an efficient and effective way. However, there is evidence that small businesses are not very good at managing their working capital. Given that many small businesses suffer from undercapitalisation, the importance of exerting tight control over working capital investment is difficult to overstate.

A firm can be very profitable, but if this is not translated into cash from operations within the same operating cycle, the firm would need to borrow to support its continued working capital needs. Thus, the twin objectives of profitability and liquidity must be synchronised and one should not impinge on the other for long. Investments in current assets are inevitable to ensure delivery of goods or services to the ultimate customers and a proper management of same should give the desired impact on either profitability or liquidity.

If resources are blocked at the different stage of the supply chain, this will prolong the cash operating cycle. Although this might increase profitability (due to increase sales), it may also adversely affect the profitability if the costs tied up in working capital exceed the benefits of holding more inventory and/or granting more trade credit to customers. Another component of working capital is accounts payable, but it is different in the sense that it does not consume resources; instead it is often used as a short term source of finance. Thus it helps firms to

reduce their cash operating cycle, but it has an implicit cost where discount is offered for early settlement of invoices.

Many researchers have studied financial ratios as a part of working capital management; however, very few of them have discussed the working capital policies in specific.

In intention to discover the relationship between efficient working capital management and firm's profitability (Shin & Soenen, 1998) used net-trade cycle (NTC) as a measure of working capital management. NTC is basically equal to the Cash Conversion Cycle (CCC) whereby all three components are expressed as a percentage of sales. The reason for using NTC because it can be an easy device to estimate for additional financing needs with regard to working capital expressed as a function of the projected sales growth. This relationship is examined using correlation and regression analysis, by industry and working capital intensity. Using a Compustat sample of 58,985 firm years covering the period 1975-1994, in all cases, they found, a strong negative relation between the length of the firm's net-trade cycle and its profitability. In addition, shorter NTC are associated with higher risk adjusted stock returns. In other word, (Shin & Soenen, 1998) suggest that one possible way for the firm to create shareholder value is by reducing firm's NTC.

Some earlier work by Gupta (1969) and Gupta and Huefner (1972) examined the differences in financial ratio averages between industries. The conclusion of both the studies was that differences do exist in mean profitability, activity, leverage and liquidity ratios amongst industry groups. Johnson (1970) extended this work by finding cross-sectional stability of ratio groupings for both retailers and primary manufacturers. Pinches et al. (1973) used factor analysis to develop seven classifications of ratios, and found that the classifications were stable over the 1951-1969 time periods

Aryeetey et al (1994) reported that 38% of the SMEs surveyed mention credit as a constraint. In the case of Malawi, it accounted for 17.5% of the total sample (Daniels & Ngwira, 1993:30-31).

(Smith and Begemann 1997) emphasized that those who promoted working capital theory shared that profitability and liquidity comprised the salient goals of working capital management. The problem arose because the maximization of the firm's returns could seriously threaten its liquidity, and the pursuit of liquidity had a tendency to dilute returns. Their study evaluated the association between traditional and alternative working capital measures and return on investment (ROI), specifically in industrial firms listed on the Johannesburg Stock Exchange (JSE). The problem under investigation was to establish whether the more recently developed alternative working capital concepts showed improved association with return on investment to that of traditional working capital ratios or not. Results indicated that there were no significant differences amongst the years with respect to the independent variables. The results of their stepwise regression corroborated that total current liabilities divided by funds flow accounted for most of the variability in Return on Investment (ROI). The statistical test results showed that a traditional working capital leverage ratio, current liabilities divided by funds flow, displayed the greatest associations with return on investment. Well-known liquidity concepts such as the current and quick ratios registered insignificant associations whilst only one of the newer working capital concepts, the comprehensive liquidity index, indicated significant associations with return on investment.

The study of (Shin & Soenen, 1998) consistent with later study on the same objective that was undertaken by (Deloof, 2003) by using sample of 1009 large Belgian non-financial firms for the period of 1992-1996. However, (Deloof, 2003) used trade credit policy and inventory policy are measured by number of days accounts receivable, accounts payable and inventories, and the cash conversion cycle as a comprehensive measure of working capital management. He finds a significant negative relation between gross operating income and the number of days accounts receivable, inventories and accounts payable. Thus, he suggests that managers can create value for their shareholders by reducing the number of day's accounts receivable and inventories to a reasonable minimum. He also suggests that less profitable firms wait longer to pay their bills. (Eljelly, 2004) explained that efficient liquidity management involves planning and controlling current assets and current liabilities in such a manner that eliminates the risk of inability to meet due short-term obligations and avoids excessive investment in these assets. The relation between profitability and liquidity was examined, as measured by current ratio and cash gap (cash conversion cycle) on a sample of joint stock companies in Saudi Arabia using correlation and regression analysis. The study found that the cash conversion cycle was of more importance as a measure of liquidity than the current ratio that affects profitability.

The size variable was found to have significant effect on profitability at the industry level. The results were stable and had important implications for liquidity management in various Saudi companies. First, it was clear that there was a negative relationship between profitability and liquidity indicators such as current ratio and cash gap in the Saudi sample examined. Second, the study also revealed that there was great variation among industries with respect to the significant measure of liquidity.

In other study, (Lyroudi&Lazaridis, 2000) use food industry Greek to examined the cash conversion cycle (CCC) as a liquidity indicator of the firms and tries to determine its relationship with the current and the quick ratios, with its component variables, and investigates the implications of the CCC in terms of profitability, indebtness and firm size. The results of their study indicate that there is a significant positive relationship between the cash conversion cycle and the traditional liquidity measures of current and quick ratios. The cash conversion cycle also positively related to the return on assets and the net profit margin but had no linear relationship with the leverage ratios. Conversely, the current and quick ratios had negative relationship with the debt to equity ratio, and a positive one with the times interest earned ratio. Finally, there is no difference between the liquidity ratios of large and small firms.

(Ghosh and Maji, 2003) in this paper made an attempt to examine the efficiency of working capital management of the Indian cement companies during 1992 – 1993 to 2001 – 2002. For measuring the efficiency of working capital management, performance, utilization, and overall efficiency indices were calculated instead of using some common working capital management ratios. Setting industry norms as target-efficiency levels of the individual firms, this paper also tested the speed of achieving that target level of efficiency by an individual firm during the period of study. Findings of the study indicated that the Indian Cement Industry as a whole did not perform remarkably well during this period.

Maness and Zietlow (2002, 51, 496) presents two models of value creation that incorporate effective short-term financial management activities. However, these models are generic models and do not consider unique firm or industry influences. Maness and Zietlow discuss industry influences in a short paragraph that includes the observation that, “An industry a

company is located in may have more influence on that company's fortunes than overall GNP" (2002, 507). In fact, a careful review of this 627-page textbook finds only sporadic information on actual firm levels of WCM dimensions, virtually nothing on industry factors except for some boxed items with titles such as, "Should a Retailer Offer an In-House Credit Card" (128) and nothing on WCM stability over time. . This research will attempt to fill this void by investigating patterns related to working capital measures within SME's in the Kumasi Metropolis.

Largay and Stickney (1980) reported that the then-recent bankruptcy of W.T. Grant, a nationwide chain of department stores, should have been anticipated because the corporation had been running a deficit cash flow from operations for eight of the last ten years of its corporate life. As part of a study of the Fortune 500's financial management practices, Gilbert and Reichert (1995) find that accounts receivable management models are used in 59 percent of these firms to improve working capital projects, while inventory management models were used in 60 percent of the companies. More recently, Farragher, Kleiman and Sahu (1999) find that 55 percent of firms in the S&P Industrial index complete some form of a cash flow assessment, but did not present insights regarding accounts receivable and inventory management, or the variations of any current asset accounts or liability accounts across industries. Thus, mixed evidence exists concerning the use of working capital management techniques.

There has been a considerable research on working capital management in North America. In their recent research on cash management practices, Anvari and Gopal, (cited in Agyei-Mensah 2012) provided evidence on the cash management practices of 123 small firms (SME's) across a variety of industries in the Canadian provinces of Quebec and Ontario.

Overall, 53 percent of the sample firms reported forecasting their cash flows. Only 26 percent of the respondent to the survey said they used formal techniques for determining the level of their cash balances. Reported methods included fixed percentage of sales, purchases or expenses. About 71 percent of firms indicated that they regularly monitor their current accounts, with smaller firms (SME's) less likely to do so than larger firms (Anvari and Gopal, 1983) (cited in Agyei-Mensah 2012).

Luoma (1976), D'Amboise and Gasse (1980), Grablowsky and Rowell (1980) have all studied inventory management practices. The latest of these (Grablowsky, 1984)(cited in Agyei-mensah 2012) outlines the inventory management practices of a sample of 94 small businesses (SME's) operating in a range of industries and located in the state of Virginia. Formal technique was rarely utilized. Those businesses which had higher inventory turnover rate were more likely to be using some sort of inventory management system, and to be evaluating the financial attractiveness of investment in inventory using payback period or discounted cash flow measures (13 percent of respondents).

Although most of the respondents in the earlier study by Grablowsky and Rowell (1980) had in excess of 30 percent of their capital invested in inventory, only 6 percent used a quantitative technique such as "economic order quantity" for optimizing inventory, and 54 percent had accounting systems which were unable to provide information on inventory turnover, reorder points, ordering costs or carrying. The above findings on inventory management practices of those small firms (SME's) of the study failed to take into account recent inventory management techniques such as Just in Time, quality control management and product engineering techniques.

A survey was also conducted on accounts payable management practices particularly those relating to cash discounts by Anvari and Gopal (1983) and Grablowsky (1978, 1984). Their results showed that less than half of small business (SME) owner-managers surveyed view accounts payable as a source of finance for their businesses. In excess of 70 percent of respondents took cash discount when they were available.

Anvari and Gopal and Grablowsky's study failed to comment on the level of application of accounts payable management practices of those firms (SME). It was silent on how often such firms reviewed their account payable. There is therefore the need to undertake a study that will depict how the frequency of usage of account payable management practices of small firms (SME).

Also in a survey of the accounts receivable management practices of small businesses (SME's) in Virginia, Grablowsky (1976) and Grablowsky and Rowell (1980)(cited in Agyei-Mensah 2012) found naïve practices to predominate. Approximately 95 percent of firms that sold on credit tended to sell to anyone who wished to buy. Only 30 percent of respondent subscribed to a regular credit reporting service such as Dun and Bradstreet. Most had no credit checking procedures and guidelines; and only 52 percent enforced a late payment charge. Thirty-four percent of firms had no formal procedure aging accounts receivable.

Overall, only 20 percent of the business in Grablowsky's (1976) survey employed a full-time credit officer and this turned out to be the most significant influence on management because of its difficulty and because they found it distasteful. Many viewed accounts receivable levels as being exogenously determined and beyond their active control. Grablowsky's finding that owner managers tended to neglect accounts receivable management because of its difficulty

may not be reliable today due to the advent of computer software's on working capital management techniques. There is therefore the need to conduct a study that reveals current perception of owner managers regarding the application of accounts receivable management. Based on the literature review it is apparent that almost all of the researches on working capital technique and generally on financial management usage in SME's had been conducted in developed countries like United States of America, Canada and some European Countries. For example the factors identified by Stuart McChlery et al (2004) as catalyst and barriers to the development of robust financial management systems were factors prevalent in the United Kingdom.

Moreover it could be seen from the literature review that many of the studies were conducted some years ago. There is therefore an urgent need to conduct a recent study on working capital management and techniques of SME's in less developed and developing countries to fill the gap indentified.

The chapter was designed to review previous studies on working capital management in SME's as well as challenges of financial and working capital management techniques in SME's. Basically many of the studies reviewed were conducted in developed countries and many of the studies were conducted some years ago and might have lost relevance in the contemporary world of business. These shortfalls on the previous studies were clearly identified as the research gap which the researcher intends to tackle in this study.

CHAPTER THREE

METHODOLOGY

3.1 INTRODUCTION

This chapter covers the steps /methods used in conducting the study.

Methodology is the section of a research proposal in which the methods to be used are described. The research design, the population to be studied and the research instrument or tools to be used are discussed in the methodology.

Based on the general principle the research methodology, strategy and techniques adopted must be suitable for the questions that the researcher seeks to answer or solve. The researcher used a combined research strategy based on survey and case study strategies through questionnaire and interviews to address the different levels of the study.

The combined strategy is based on the concept that: (no single method ever adequately solves the problem”). Using one method is more vulnerable to error linked to that particular method. The researcher used the combined approach to increase the authenticity and relevance of the research conclusion and also to be more confident about the research findings, increase the strength of generalization, provide a solution linking the research objectives and research questions adequately and proficiency.

3.2 SOURCES OF DATA

As already stated in our chapter introduction, the main sources of data were from both primary and secondary sources.

3.2.1 Primary Data

Data from this is basically from internal members of the business which comprises the owners of small scales and medium scale enterprises, supervisory staff and management personnel. Data collection instrument used were questionnaire, discussion and interviews.

3.2.2 Secondary Data

Data from these sources was from Business Bulletins, publications, journals and articles from the internet.

3.3 POPULATION

There are over 1500 small and medium enterprises that are established in the Kumasi Metropolis and about 350 registered with the Registrar General Department and the National board for small scale Industries from 2005 to date.

The population was made up of SMEs in the Kumasi metropolis.

3.4 SAMPLE TECHNIQUE

The technique that was adopted was non probability sampling. non-probability sampling is “a sampling technique in which unit of the sample are selected on the basis of personal judgment or convenience; the probability of any member of the population being chosen is unknown”.

It would be impracticable to survey the entire population. Therefore, hundred (100) SME’s were randomly selected within the Kumasi metropolis the capital of the Ashanti Region of Ghana to represent the sample size.

These SME's dealt in the buying and selling of goods like electrical and plumbing materials, shoe making, mobile phones, paints, tires, stationery, clothing, fuel and lubricants in Kumasi. These SME's were selected to form the sample of the population because they represent the major part of the small in the Kumasi metropolis.

3.5 DATA COLLECTION INSTRUMENTS

The data collection process was designed to collect data on working capital management of SME's in the Kumasi metropolis. The instruments used in the collection of data were questionnaires, discussions and interviews. The respondents were interviewed based on a questionnaire to solicit data on the working capital management of the businesses. Both open and closed ended questionnaire items were used. This type of instrument is purposely for those who can read and write. For those who cannot read and write discussions and interviews were employed. The researcher finds no problem having to explain the technical nature of some of the questions to those owners with financial background. However, the researcher had to explain the questions in the local dialect to those owners with no educational background. A dichotomous response items were also adopted to enable the use of Yes and No answers which is easy to adopt.

3.6 DATA ANALYSIS TECHNIQUES

The data collected were analyzed in relation to the research problem. All the computations were done statistical package for social scientist and Microsoft excel. In scoring or grading responses which form the next chapter, the researcher made tables and charts and indicated the effectiveness of working capital management in the various businesses. Most of the financial ratios which form part of the main analysis in knowing the worth of working capital management were not employed because of the researcher's inability in gaining access to the

financial statement of the respondents. The ratios that were adopted include the average collection period, average payment period, inventory turnover period, operating cycle and the cash conversion cycle.

3.7 ACCOUNTS RECEIVABLES MANAGEMENT

According to Cunningham *et al* (2000) businesses make sales on credit for two basic reasons: (1) selling on credit may be more convenient than selling for cash and (2) offering credit will encourage customers to buy items they might not otherwise purchase. Chandra (2008) noted that while business firms would like to sell on cash, the pressure of competition and the force of custom persuade them to sell on credit. It is valuable to customers as it augments their resources-it is particularly appealing to those customers who cannot borrow from other sources or find it very expensive or inconvenience to do so..

Accounts payable are debts that must be paid off within a given period of time in order to avoid defaults. Inventory Turnover Period (Days) is the length of time items are held in inventory before being sold. Operating cycle is the time between purchase of inventory and eventual realization of cash from their sale. Cash conversion cycle is a liquidity ratio which measures the length of time that the company has to finance trading activities from other sources.

The data analysis was based on the responses received from the respondents.

CHAPTER FOUR

EMPIRICAL FINDINGS, ANALYSIS AND INTERPRETATION

4.1 INTRODUCTION

The chapter is basically a presentation and analysis of data collected from the field. The data was obtained through interviews, administered the questionnaires with the respondents, we had an excellent response of a hundred (100%) percent. Out of the total number of hundred (100) SMEs representing the sample data in Kumasi, all responded to the questionnaires. The areas covered in this chapter include:

4.2 BACKGROUND ANALYSIS OF RESPONDENTS/DATA

These include the age distribution, educational background and the responses as to sources of initial capital.

Table 4.1

4.2.1 Age Distribution of Respondents

	Frequency	Percent	Valid Percent
20 years and below	5	5	5
20-40 years	59	59	59
40-50 years	23	23	23
50 years and over	13	13	13
Total	100	100	100

Source: Field Survey, May 2012

From the age distribution, it could be seen that those engaged in SME's today are the youth (59% i.e. over 20-40years) and few respondents are under 20years and over 50 years. This could be attributed to some factors. Foremost, it could be that the youth are vibrant and very

strong to work at that age. Secondly, it could be that those below 20years are supposed to be in school at that age and do not find the SME venture lucrative. In addition, it could be that those under 20years engage in apprenticeship, therefore, before they pass out their age would be over 20years. Another reason could be that the old are stereotyped; they might think that at their age they are not competent enough to manage a business effectively.

Table 4.2

4.2.2 Educational Background of Respondents

	Frequency	Percent	Valid Percent
Basic/Elementary Education	15	15	15
Secondary Education	60	60	60
Tertiary Education	25	25	25
Total	100	100	100

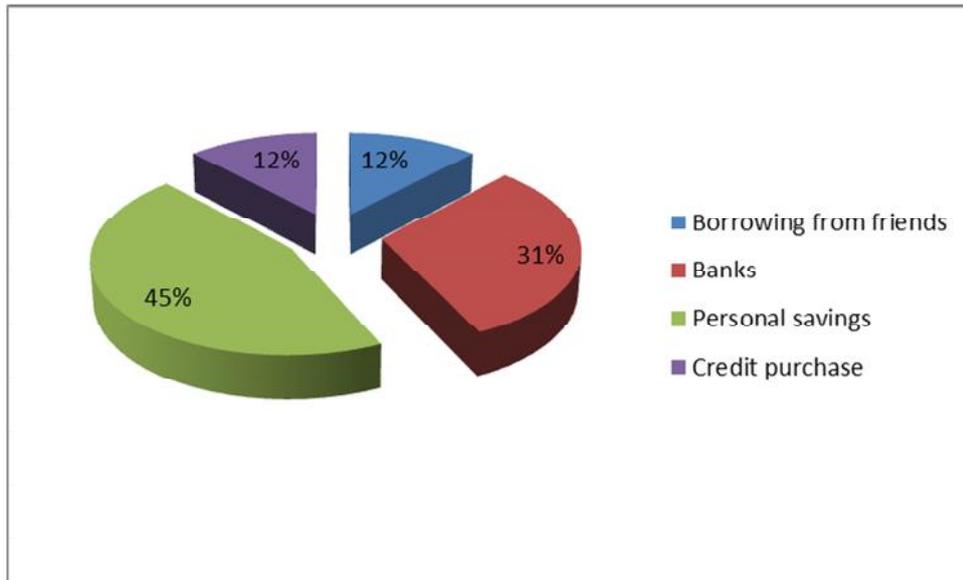
Source: Field Survey, may2012

From the table above, 75%, that is 75 respondents, represents those with basic and secondary education. This shows that most of the people engaged in SMEs do not have accounting and managerial competence to put up appropriate measures to run the business. This might be the reason why most of the businesses are stifled in nature. However, it is interesting to see that 25%, that is 25 of the respondents have attained tertiary education. This indicates that, gradually, learned people are getting involved. It could be predicted that in some years to come the managers or owner are going to be people who have needed managerial skills to steer the business. But, as it stands now majority of the respondents do not have the requisite managerial skills to run the business. During interviews, most of the respondents could not give a vivid account of their vision. Some of the SMEs owners described their business now

as a pale shadow of the vision that they nursed before entering into those ventures. This also contributes to the inadequate competences of the SMEs.

Figure 4.1

4.2.3 Sources of initial capital



Source: Field Survey, May 2012

With reference to the diagram above, a greater population of the respondents got their initial capital from their own coffers, that is, personal savings. Small amount of the respondents obtained capital from friends with reasons that, their friends did not find their ideas as laudable and profitable and as such did not want to risk their precious money. 31 out of the 100 SMEs interviewed which forms 31% of the whole, received initial capital through bank loans. When the researchers asked why they were not relying on banks for their initial capital, most of the respondents answered that, they could not obtain collateral securities for the amount demanded. Also the rate of interest on the required loans was too high. The table further revealed that only 12 people out of the 100 respondents bought material on credit as a way of building initial capital. Buying on credit is one of the popular ways of preserving and gaining cash for other purposes in a business. Many of the respondents were not employing

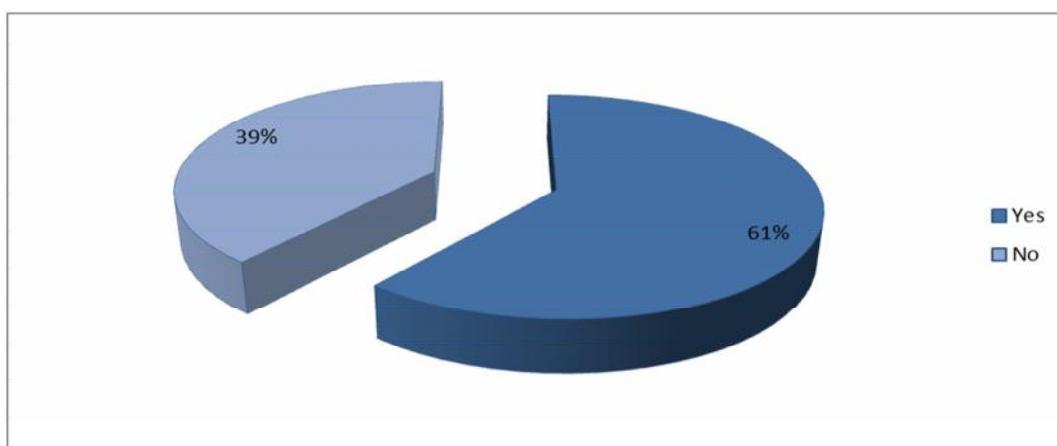
the credit purchase technique for reasons such as fear of harassment or embarrassment from suppliers and being looked on as not creditworthy. A successful business requires the application of tact wisdom, innovation and ability to contain what others would say about you. People, who therefore fear harassment as a result of taking credit, often turn to depend on their own effort of personal savings which usually did not produce the immediate cash requirements of a growing business. It is not surprising that majority of the respondents depend largely on personal savings as a source of start-up capital.

4.3 PREPARATION OF FINANCIAL STATEMENT AND REPORT, THEIR USE AND IMPACT ON THE BUSINESS

The researchers examined how the SMEs make use of financial reports and accounting statements that are essential for application of working capital management. The researchers considered accounting statements and financial reports as a bedrock of the application of working capital management. As a matter of fact SMEs that fail to prepare proper accounting statements and financial records will almost invariably fail to apply working capital management, and the impact on preparing the financial statement on the business

Figure 4.2

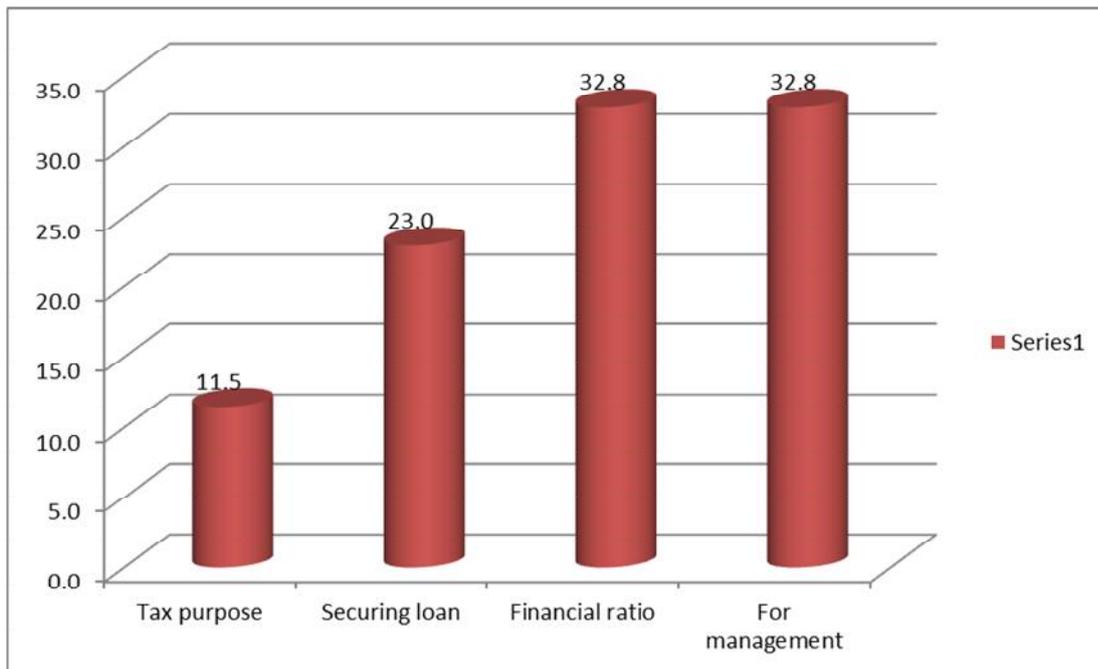
4.3.1 Preparation of Annual Financial Statements



The survey depicted that 39% of the selected SME's did not prepare monthly management accounts. Whereas the other 61% said they prepared monthly management accounts. Out of the 61 respondents who indicated that they prepare annual financial accounts, only 30(49%) were able to provide copies of their management accounts. Moreover, very few of the firms that did not prepare annual financial accounts did keep books of prime entry. From the above, it is a clear indication that there are high standard of financial record keeping among the selected SMEs. If accounts are regularly and properly kept, comparative figures could be derived so that improvements and downturns could be quickly identified and reacted upon accordingly.

Figure 4.3

4.3.2 Reasons for the Preparation of Financial Statement



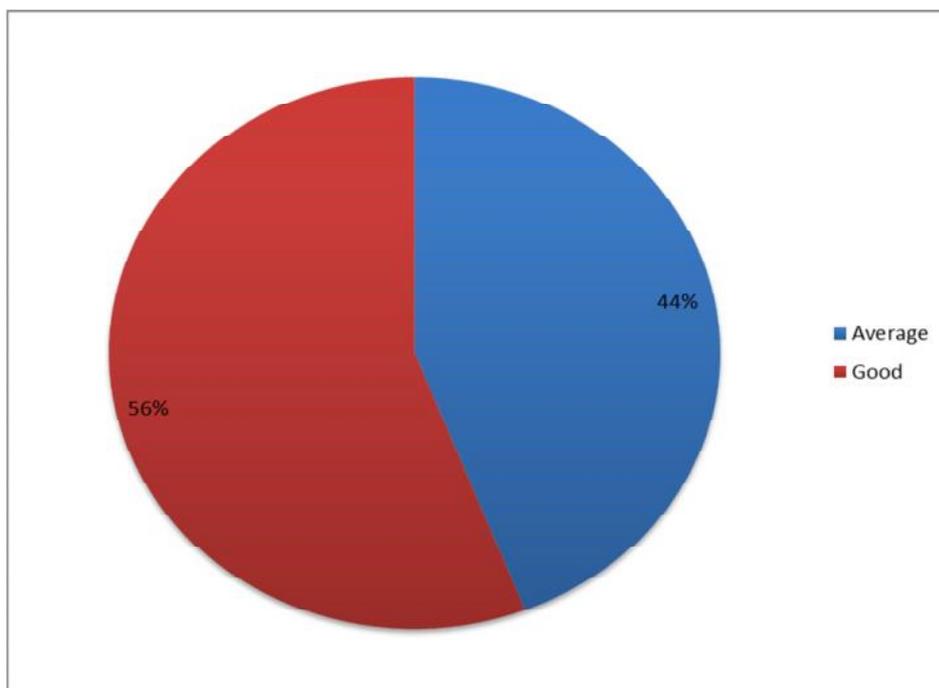
Source: Field Survey, May 2012

From the table above, most of the respondents did not pay attention to tax. This indicates that, most of the selected SME's thus not prepare the annual financial statement to fill for tax. From the looks of things most of them don't pay tax to the Ghana revenue authority. In

summary, this is a flaw in the working capital management practices of these SMEs. Ghanaian are now knowing the important of calculating ratios to compare financial performance over the years, and letting managers knows their performance at the end of the year

Figure 4.4

4.3.4 Impact of Preparing Annual Financial Statements



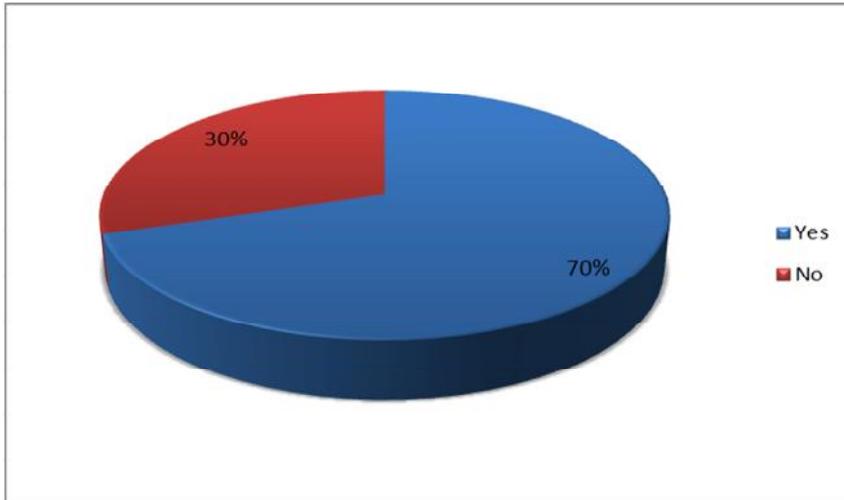
Source: Field Survey, May 2012

Out of 100 SME's selected 61 of them prepare annual financial statements for the following reasons, for tax purpose, for securing a loan, for ratios analysis, for management. Considering all this and the pie chart above, it's indicate at SME's in Kumasi prepare financial statements annually and its having a positive impact of the performance of their business.

4.4 WORKING CAPITAL MANAGEMENT/ NEEDS

Figure 4.5

4.4.1 Understanding of Working Capital



Source: Field Survey, May 2012

Based on the field survey done by us, it does indicate that 70% of the selected small and medium enterprises selected in Kumasi understand the meaning of working capital. But 30% does not even know the meaning of working capital. This is very bad for the economy of Ghana. If the SMEs are the back bone of the country and about 30% does not understand working capital.

Figure 4.6

4.4.2 SALES TO CUSTOMERS

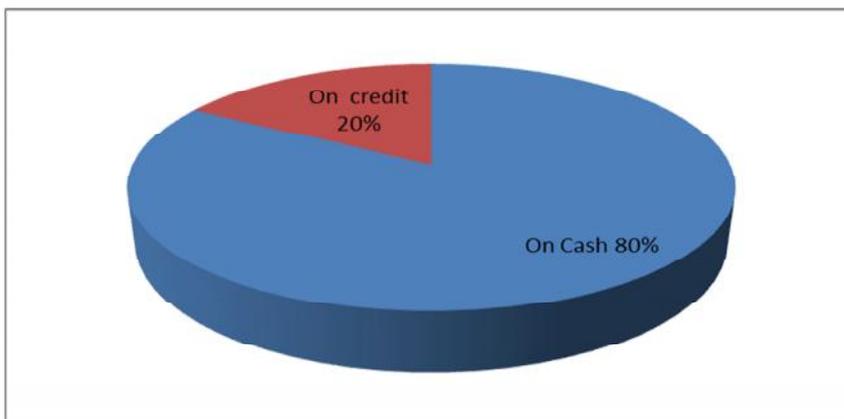


Table 4.3

4.4.3 Average Collection Period (Debtor Days)

Period (days)	Frequency	Percentage (%)
Not available	80	80
1 – 15	4	4
16 – 30	10	10
Above 30	6	6
Total	100	100

Source: Field Survey, May 2012

Receivable are as a result of entrepreneurs extending credit to their customers. The amount of account receivable, which is an asset on a business' financial report, depends on the number of customers the SME has, the volume of the sales and the amount of credit extended to its customers.

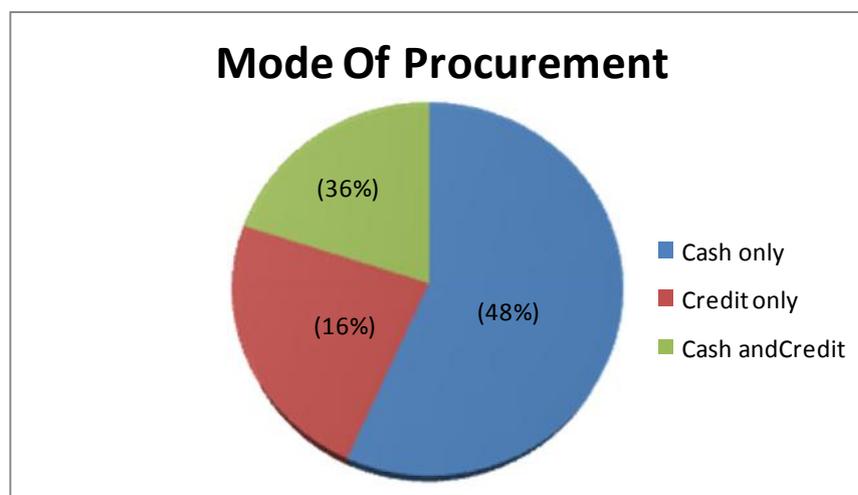
From figure 4.4, it could be seen that out of the 100 respondents, 20% sold on credit to customers. From the analysis, it is clear that not majority of the SMEs sold on credit to customers, whilst the remaining sold for cash. With this, SME's would need to have a good debtor policy which could cover area such as shortening allowable debtor days, debt recovery strategy such as the ability to collect money from non-paying customers, ageing debt strategy, bad debt policy such as factoring among other things or else they would be cash trapped. The importance of this can never be over emphasized if the SMEs seek to achieve good liquidity position and profitability. In doing this, the SMEs should take into consideration important issue such as industry wide practice and average with respect to debtor days, cost to the business, competitor's practices, peer companies and other relevant information such as industry benchmarks. Theoretically, it is not advisable to sell a chunk of your inventory on credit but in practice it is the industry in which the SME's operates that determines the mode of operation. In extending credit to a particular customer, proper background check and check of credit worthiness must be done. It should be noted that it is

not sales that increase cash inflow rather cash sales, payment from debtors and advances or deposits. Most of the time, it is almost inevitable for a business not to sell on credit in a real world. Therefore the issue then narrows down to the number of days allowable for trade debtors to settle the balances on their accounts.

Collection of accounts receivable or debt collection is an important source of SMEs cash flow and business finance. As such, learning about accounts receivable analysis can prove vital for entrepreneurs. This period becomes an important issue for management to decide on. In doing this, management should consider issues such as industry-wide norm, the cost of selling on credit to the business, the risk of default or non-payment, its effect on cash flow and cash needs of the business. As shown in the table 4.3 above, most of the firms (14%) had receivable period of not more than 30 days. On the whole or surface these looks good, but let's not forget the very important factors such as industry average, cost to the business and impact on cash flow. SMEs should try to negotiate for short receivable days so long as it doesn't impede their competitive position and the inconveniences of their customers.

Figure 4.5

4.4.4 MODE OF PROCUREMENT



Source: Field Survey, May 2012

In business, it is prudent to take advantage of trade credit if it is available. This is because cash that would be tied in stock could be used for other commitments or even invested elsewhere for additional gains. Account payable are analyzed by the average number of days it takes to pay off a supplier's invoice, for example short term payments to suppliers and banks.

From table 4.5, 48% of the respondents bought goods or raw materials with cash, 16% buy on credit and 36% use both means.

On the surface, this implies that most of the SME's bought goods on both cash and credit basis. Since most of them bought with cash it reduces cash at hand which usually causes cashflow stress for the businesses.

Table 4.4

4.4.5 Average Payment Period (Creditor Days)

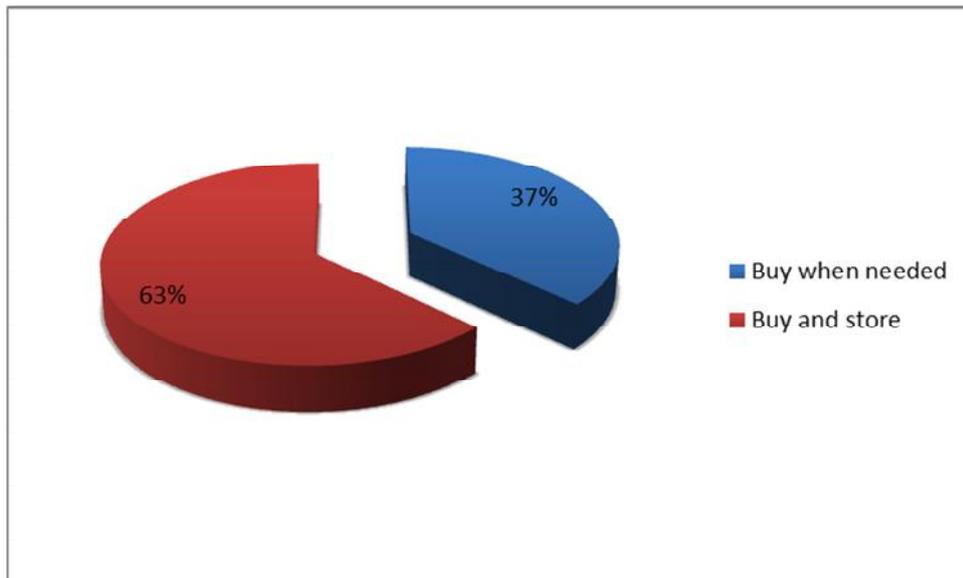
Period (days)	Frequency	Percentage (%)
Not available	56	56
1 – 15	20	20
16 – 30	16	16
Over 30	8	8
TOTAL	100	100

Source: Field Survey, May 2012.

From the table above, most of the respondents (48%) bought their goods or raw materials on cash basis. This was not a favourable result as compared to the information in table 4.4. It should be noted that payment to creditors depletes cash on hand and create stressful situation especially when there is no immediate realisation of cash from sales. Most company do not can take advantage of paying their debt over 30 days. This normally reduce the amount of working capital that the business's used to management their business.

Figure 4.6

4.4.6 Motive of Holding Stock



According to the respondents, inventory is the most important component of current asset of their business. It is the force that holds the business together in terms of providing cash. In view of this inventory should be properly managed because having too much inventory than needed could have the negative effect of locking up operational capital and having too little can lead to stock outs.

From the diagram above 63% of the respondents bought inventory and stored while 37% went in for the stock when needed. This means a greater proportion of the SMEs under the study purchased and stored goods in anticipation of future sales. An unfavourable sale as anticipated would lead to excess stocks being held, which leads to extra warehousing cost (that is if they have any significant storage cost). On the other hand, if sales move faster than anticipated for, it could lead to stock outs which could result in the loss of customer's loyalty and revenue.

Table 4.7

4.4.7 Inventory Turnover Period (Days)

Period (days)	Frequency	Percentage (%)
Not available	37	37
1 – 15	12	12
16 – 30	17	17
Over 30	34	34
TOTAL	100	100

Source: Field Survey, May 2012.

Inventory turnover period measures the length of time items are held in inventory before being sold. It recognizes the relationship between the total amounts of item consumed during the year, that is, cost of sales and the amount of that item held at the year. Businesses will want to ensure that inventory day's period is kept as low as possible since longer inventory holding period means extra warehousing and security cost. More critically, it also means additional amount of cash tied up in inventory. However, this would need to be balanced against the need to have inventory available as necessary.

From the table above, 12 of the respondents had their inventory turnover period not higher than fifteen (15) days. 17 also had their inventory turnover period between 16 to 30 days. This means 34 of the total respondent had their inventory turnover period under 31 days (one month) which looks very good because the lower the inventory turnover period the more efficient management is perceived to be, all other things being equal. 40 had no idea of what their inventory turnover was. On the other hand, 34 of the respondents had their inventory turnover period above 30 days which was also not very bad as well, comparatively the respondent with inventory turnover period above 30 days did not have a very good turnover

period but management should not be seen as inefficient because some of these SMEs dealt in seasonal and highly valued items so their inventory figure may give an unrepresentative result.

Cash and Fund Management

Cash is the life blood of every business since it is used to operate the day to day activities of the firm. Cash is the money that is easily accessible either in the bank or the business. It is not inventory, it is not account receivable and it not property. These might be converted to cash at some point in time, but it takes cash on hand or in the bank to pay suppliers, rent and to meet the payroll. Profit growth could not always mean more cash.

From the study conducted, the major source of cash inflow to the selected SME's was sales. Most of the selected SME's depended highly on sales or payment by the customers in exchange of goods delivered. According to the figure 4.6, the greater proportion of the sales was cash sales. 20% of the trade customer bought goods on credit and made payment in the future. This implies that a lower proportion of the sales constitutes credit sales.

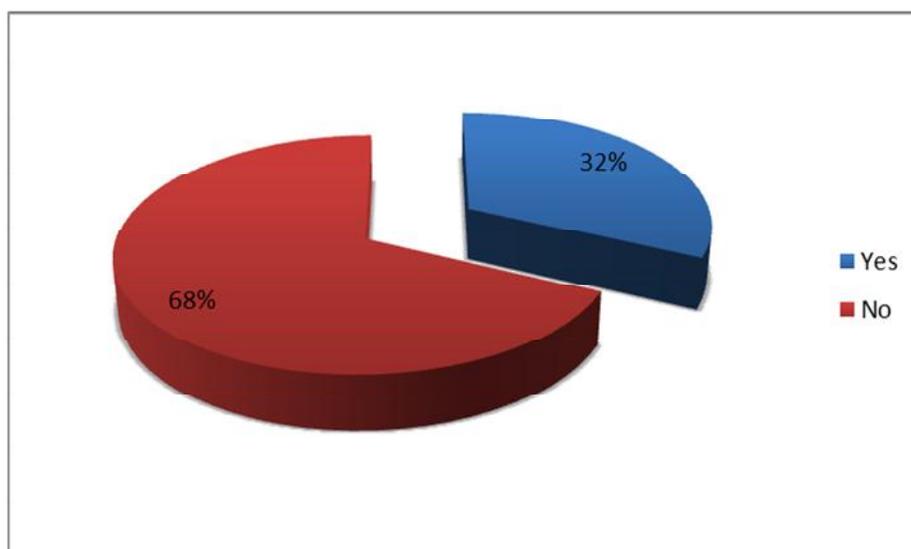
According to the research conducted, the major source of the cashoutflow was purchase of inventory. Also, cash left the business through payment of wages and salaries to employees of the firm. Warehousing cost was also a way by which money or cash went out of the selected SME's. From the interview conducted, most of the respondents fancied paying suppliers cash immediately. Their view was that paying suppliers instantly shows how efficient they were. However, this should not be the case, businesses should try to negotiate for credit facilities so that the cash received from trade debtors in hand and the extra cash

held could be invested in a profitable short term (risk free) investment such as treasury bill rather than paying trade creditors instantly.

The SME's should therefore adopt means and strategies to get prompt and early receipt from trade debtors to enhance cash inflow since selling on credit cannot be totally ignored. The SME's should also enrich their cash management by embarking on credit purchases through effective negotiation and better relation. The management or owners of the SME's should employ a strong bargaining power in order to extend payment to trade creditors or suppliers in a latter day.

Table 4.8

4.4.8 Bargain on Commercial Credit



Source: Field Survey, May 2012

Individuals and businesses who borrow mostly from banks have the opportunity to bargain on interest payable charges and terms of credit. From the survey, 68% did not bargain. 68% of our respondents were not doing themselves any good when it comes to their borrowing practices. This affected the cash flow of the business because these charges and interest were cash outflow and such needed to be managed.

In business, firms experience surplus cash or idle cash for short periods from time to time. It is therefore prudent to invest these surpluses as and when they arise. Common practice in large companies is to employ accounting and finance experts to manage such funds, which makes arrangement for all of these activities. SME's do not have the luxury to employ such experts but can do something in their own way to tackle this issue. They can arrange for call accounts with a sweep mechanism with their Bankers. A call account is a high interest yielding account that could be accessed at anytime. So cash surpluses could be swept from regular bank accounts into a call account until it is needed. This is a much proactive means of investing since it is more or less automated if arranged for.

From the survey, the respondents were helping themselves in this direction. Very few of them did walk-in investments such as treasury bills, fixed deposits and the likes.

The chapter revealed the empirical findings on the background of the respondents, accounting statements and financial reports as well as working capital management practices among the SMEs. The findings obtained set the tone for the researchers to make relevant conclusions and recommendations.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS.

5.1 SUMMARY OF THE FINDINGS

The foundation of the study was on the assumption that SMEs do play a major role in the world economy and that they are recognized as the main contributors to economic development and employment. The effort on the part of the government, NGO's and other financial institution in extending numerous forms of support to SMEs is very low and as such operational and managerial incompetence continue to be a characteristic of this industry. In a developing country like Ghana, SMEs do represent a greater percentage of the total number of enterprises and their contribution to the economy is very significant. For example in Ghana SMEs accounted for about 60% of the Gross Domestic Product (GDP) with three quarters of the population deriving their livelihood from this sector (Ghana News, 2006).

SME's do not have in-depth knowledge on financial and accounting issues and also do not have the requisite skills to handle the management of working capital effectively because they do not employ professionals.

Most SME's in the Kumasi Metropolis believe in and also practice cash purchases even when credit could be available. This evidence was gathered through the interviews conducted with the various business owners and managers. As a result of this practice, they have high demand for cash.

They also do not attach much importance to financial records and subsequent preparation of financial statements. Majority of the business owners have formal education only up to the

secondary level (that is 75%). This means they do not have requisite knowledge in commerce to manage the business effectively.

The study revealed that the number that prepared annual financial statement is more than those who did not prepare annual financial statement. Furthermore, the survey revealed that the owners of SME's who have accounting background are few because a significant number said they employed the services of external accountants to handle their financial statement.

It also came out during the survey that almost all of the respondents had some reason for preparing financial statement. Furthermore, a significant proportion had ratios analysis and management purpose as their reason for preparing financial statement followed by securing a loan. Tax purpose was the least reason why SME's prepared financial statement.

SME's under the study happened to procure their inventory through cash basis or credit, sometimes even both. Most of the respondents practiced both cash and credit purchases with less credit purchase, though it could be available. It was perceived that credit purchases are a bad practice by most of these entrepreneurs.

The survey revealed that a greater proportion of the SME's purchase and store goods for future sales while a less significant number purchase the goods only when needed. Out of those who buy and store, most of them happened not to have a proper inventory management technique to regulate the flow of inventory. The study further revealed that a majority of the respondents had an inventory turnover period above 30 days.

During the interview, it came to light that the SME's under study had a huge debt portfolio because of their credit sales arrangement. SME's had no other means of recovering their debts, aside the use of the Police which could be costly and ineffective.

From the survey, the effectiveness of the management of cash is not very sound. The rate of cash outflow does not generate a proportionate cash inflow immediately. That is, a greater percentage of the SME's studied acquire their inventory with the immediate payment of cash. Twenty (20%) sells their inventory to customers on credit which is not a good practice. They buy with cash and sell on credit. This practice indicated that the cash at hand was either at a deficit or very low.

5.2 CONCLUSION

It was gathered from the findings that improper application or lack of knowledge on working capital management was the major setback that limited their profit, growth and expansion. This also had influence on the short-term finances and liquidity of these businesses. From the study, most of the SMEs surveyed acquired their inventory by paying cash on the spot (cash purchases) but came back to sell a greater portion of that inventory on credit (credit sales). As a result this led to cash inadequacy for the day-to-day operations of these businesses. Based on the analysis of the data gathered, it is evident that proper working capital management application will improve their financial base. It can be noticed from the findings that SMEs in the Kumasi metropolis did not keep proper books of accounts necessary to perform financial analysis to make sound management decisions. Thus, these SMEs had difficulty in understanding and preparing management accounts which is very fundamental in the management of working capital. For a business to be successful there should be sound management practices. Unfortunately, the data gathered showed SMEs did not have a sound

working capital management practice. For example the SMEs that bought and stored goods did not have any inventory management technique. Moreover the lack of sound working capital practices could be attributed to failure in employing personnel with the needed accounting knowledge to help SMEs prepare and analyse their working capital worth. From the interviews conducted the SMEs indicated that they would want to know more about working capital management but they are being restricted by the unavailability of seminars and workshops. The study focused on the good working capital management for a better cash flow requirement

Looking at the immense contribution of the SMEs towards the Ghanaian economy and development, it is proposed that the government should liaise with the SMEs in organizing workshops, forums and seminars on the need for the practice of working capital management. In addition, the SMEs should come together to form cooperative unions to help and promote their operations, existence and survival in this modern and dynamic business environment. The findings of the study were that no effective working capital management was being practiced in the targeted area.

5.3 RECOMMENDATION

With regards to the findings of study into the working capital management of SMEs, the researchers would like to make the following recommendations to the managers and owners of SME.

- i. The maintenance of financial manager position within the firm to gauge the credit policy and debt repayment system of the firm, to ensure professional financial management practice within the firm. Where the firm is a small firm the service of a financial consultant could be engaged on regular basis to ensure strong financial position.

- ii. Periodic financial report should be prepared by the small business owner using the service of professional accountant; this will enable the entrepreneur to ensure strong financial position
- iii. A strong credit policy system that will ensure that account receivable period is shorter than account payable period.
- iv. Cash should not be used as gauge for performance, but the financial report should be used rather to gauge performance. Most entrepreneurs only run on cash basis. They only monitor their cash position without taken cognizance of their debt position.
- v. SME's should therefore try to negotiate good credit terms with their suppliers to cushion against the receivable period granted to trade debtors in order to prevent them from cash inadequacy and its related problems
- vi. It is further recommended that the SME's should learn more about factoring and employ their service in the collection of their trade debts
- vii. It should also be noted that stretching the payment period given by a creditor spoils an entity's reputation, also the creditor can decide to reduce or stop giving goods on credit.
- viii. SME's should seek business advice to educate them on the importance and the need for them to manage their working capital effectively to ensure their smooth operations

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APPENDIX

CHRISTIAN SERVICE UNIVERSITY COLLEGE

BACHELOR IN BUSINESS ADMINISTRATION DEPARTMENT

This questionnaires is solely for academic purpose and all information provided will be treated as confidential, please tick or fill where applicable

1. What is your age
 - a. 20 years and below
 - b. 20 – 40 years
 - c. 40 – 50 years
 - d. 50 years and over

2. What is your educational background
 - a. Basic/Elementary education
 - b. Secondary education
 - C. tertiary education

3. What is the name of the Business (sme)?
.....

4. What type of product or service that you engage in?
.....

5. How long have you been in the business?
.....

6. Do you understands working capital
 - Yes
 - NoIf yes explain

7. Do you think the management of working capital is important
 - Yes
 - No

8. If borrowing, where do you normally borrow from?
 - a. Personal savings
 - b. relative
 - c. money lenders
 - d. banks

9. Do you practice working capital management?
 - Yes
 - No

If yes what is its impact in your business using the following rating

- a. Poor b. below average c. average d. good

10. Do you prepare annual financial statements?

- Yes No

11. What are your reasons for preparing financial statements?

- a. Tax purpose b. securing a loan c. financial ratio analysis d. for management

12. On what terms do you obtain your goods or raw materials?

- a. On cash basis b. on credit basis c. both

13. What percentage of your sales constitutes credit sales?

- 1 – 15 % 16 – 30 % 30 % and above

14. How many days does it take for customers to pay?

- 1 – 15 days 16 – 30 days 30 days and above

15. What are your stock holding motive

- a. Buy when needed b. buy and store

16. Do you know the cost of holding stocks?

- Yes No

If yes, about what percentage of your total expenses represents storage cost?

- 1 – 5% 6 – 10% 11 – 15% above 15%

17. What percentage of stock represents your minimum re – order level?

- 1 - 10% 11 – 15 % 21 – 30%

18. What percentage of stock represents your maximum re – order level?

- 51 – 60% 61 – 70% 71 – 80% 80% and above

19. Do you have other alternative source of supply?

- Yes No

20. What is your inventory turnover period?

1 – 15 days 16 – 30 days over 30 days

21. Which of the following means do you employ most in raising initial working capital?

a. Borrowing from friends' b. banks c. Personal saving d. credit purchases

22. Do you offer discount for prompt payment

Yes No

23. How long does it take your business to pay creditors?

1 – 15 days 16 – 30 days over 30 days

24. Do you understand what a cash conversion cycle is?

Yes No

25. Do you bargain on your borrowing rate and terms from the banks?

Yes No