

Working Capital Management and Business Performance of Small and Medium Enterprises in Nigeria

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Abstract

Deficiencies in financial management skills have been repeatedly cited as a root cause of business failure in many countries of Europe, Asia and Africa. In Nigeria, enough evidence has shown that a number of small and medium enterprises failure were as a result of poor financial skills like working capital management. The objective of this paper is to establish a relationship between working capital management and business performance of small and medium enterprises in Nigeria. The reasons for this study is enable government agencies to develop and design programmes and policies that will help the small and medium enterprises improve their performance in economic development of the country in areas of employment generation and addressing the problems of poverty in the country. A descriptive survey is used to analyse the primary data. The result had shown a significant relationship between working capital management and business performance of small and medium enterprises in Nigeria. Advanced statistical analysis was conducted using correlative analysis to obtain sssfinal result of the study. The sample of 30 registered SMEs drawn from the target population in Kaduna metropolis.

Keywords: Working Capital Management, Business Performance, Small and Medium Enterprises.

Background to the Study

The Small and Medium Scale (SME) business remain the most dynamic force and agent of economic growth and development of a nation. The small and medium scale enterprises generates at least 60% of the USA GDP (Ovia, 2001) In Nigeria, the SMEs are all around us, the fact that only few amount is required to start an SMEs make it the most popular term of business. The SMEs constitute the major breakthrough in several emerging sectors. Most breakthroughs in (IT) in the U.S.A were propelled by SME. Microsoft Disk Operating System (MS Dos) that enabled about 80% of the world PCS to operate was developed in 1980 by Bill Gates and Paul Allen when their company was a small scale enterprise.

In India, IT industry exported about 6 billion software's and related services in year 2000. This amount is just a little less than Nigeria's oil revenue of \$9 billion for the same period (Ovia, 2001). However, several SME in Nigeria fail in a little time after they are started; most fail due to poor financial management especially the working capital management. Most SMEs do not engage their working capital in such a way as to enjoy maximum profit (Geoffrey, 1969). The combination of debtors' management strategy, cash management, account payable (or

creditors) and most importantly stock management strategy left much to be desired by the SME. This work will evaluate various working capital management strategies and their effective application by SME; most small businesses (SMEs) do not manage their short-term fund effectively. The net working capital are most times ignored, thus, they run into insolvency. The need to evolve a proper working capital management is important for good solvency and liquidity of the firm.

Regarding cash management practices, Grablowsky (1978) and Grablowsky and Rowell (1980) conducted a questionnaire survey concerned with the cash management practices of 66 small enterprises from a number of industries located in and around Norfolk, Virginia. The results showed that 67 percent of respondents replied they did not do forecasting of cash flows. When asked how they determined the level of cash to be held by the business, less than 10 percent of enterprises reported using any type of quantitative technique. The method most often employed was to hold cash as a fixed ratio of projected expenses, forecasted sales or anticipated purchases. Non-quantitative methods used consisted of meeting compensating balance requirements, maintaining the level considered safe by management or achieving a level recommended by outside advisers. Additionally, seventy-one percent of business in the Virginia survey reported that they had no short-term surpluses of cash in their recent history. Only 23 percent had a long-term surplus. Nearly 30 percent of respondents had invested excess cash in earnings securities or accounts. The most common investments were savings accounts, certificates of deposit, treasury bills, repurchase agreements, commercial papers, shares, bonds and other investments.

Based on Cooley and Pullen's (1979) research, cash management was seen as the process of planning and controlling cash flows. It consisted of three basic components: cash forecasting practices, cash surplus investment practices and cash-control practices. Cooley and Pullen (1979) examined cash management practices of 122 small businesses engaged in petroleum marketing and reported that 73 percent of respondents had experienced a cash surplus.

In contrast to Grablowsky and Rowell's (1978) and Cooley and Pullen's (1979) survey, Murphy's (1973) study indicated that active cash management in small enterprises in the UK was unusual, and that there was little inclination to invest surplus cash on a short-term basis.

Evidence on the cash management practices of 123 small enterprises across a variety of industries in the Canadian provinces of Quebec and Ontario was provided by Anvari and Gopal (1983). Generally, 53 percent of the sample businesses indicated that they prepared cash forecasts, substantially higher than the 30 percent figure reported by Grablowsky (1978, 1980). Respondents were also asked the basis for determining the level of their cash balances. Only 26 percent of respondents indicated they used formal techniques, using a fixed percentage of sales or expenses, for determining the level of their cash balances.

Regarding accounts receivable management practices, Grablowsky (1976) and Grablowsky and Rowell (1980) found generally low standards. Approximately 95 percent of businesses that sold on credit tended to sell to anyone who wished to buy. Only 30 percent of respondents subscribed to a regular credit reporting service. Most had no credit checking procedures and

guidelines, and only 52 percent enforced a late-payment charge. Thirty-four percent of businesses had no formal procedure for aging accounts receivable. Bad debts averaged 1.75 percent of sales, with a high of 10 percent in some concerns. Murphy (1978) revealed a very high level of awareness and utilization of credit control systems in the UK, even in the smallest businesses.

On inventory management practices, D'Amboise and Gasse (1980) studied the utilization of management techniques in small shoe and plastic manufacturing industries in Canada and found 64 percent of shoe and 65.4 percent of plastic businesses employed formal inventory control systems. While Grablowsky and Rowell (1980) found that most of the respondents had in excess of 30 percent of their capital invested in inventory, the general standard of inventory management was poor. Only six percent of businesses in their survey used a quantitative technique such as economic order quantity for optimizing inventory and 54 percent had systems which were unable to provide information on inventory turnover, reorder points, ordering costs or carrying costs. Related to the methods used to determine inventory level, Grablowsky (1984) compared methods used by a sample of 94 small enterprises with those used by large enterprises and found that large enterprises used methods to determine inventory levels far more than small enterprises.

Unlike the researchers mentioned above, Peel and Wilson (1996) studied working capital management practices of small firms based in the North of England without any separation of cash management, receivable, payable and inventory management but dealing with working capital components. In their research, respondents were requested to indicate the frequency with which they used or reviewed various methods or components pertaining to the management of working capital.

Statement of the Problem

The problem is to find the relation between working Capital Management and Performance of manufacturing sector small and medium sized enterprises in Nigeria. The research will find the relation between the working capital management indicators specifically stock holding period, accounts receivable period, accounts payable period, and length of cash conversion cycle and the profitability measures namely gross profit ratio (GPR) and operating profit margin (OPM) and return on total assets (ROTA).

Working capital management is important because it consists of considerable amount of current assets and current liabilities of small and medium sized enterprises. Performance includes gross profit (GP) and operating profit (OP) and return on total assets (ROTA).

Purpose of the Study

Working capital management is particularly important in small and medium- sized companies. Most of these companies' assets are in the form of current assets. Also, current liabilities are one of their main sources of external finance. In this context, the objective of the current research has been to provide empirical evidence about the effects of working capital management on the profitability of a sample of manufacturing sector small and medium sized Nigerian firms. The

main objectives of the research are as follows; evaluate the relation between working capital management and performance of manufacturing sector small and medium sized enterprises in Nigeria. This includes identifying the effect of working capital management on the profitability of the manufacturing sector small and medium sized enterprises. Identify the importance of working capital management in small and medium sized manufacturing sector enterprises. Examine the impact of accounts receivables days (ARD), inventories days (ID), accounts payable days (APD) and cash conversion cycle (CCC) on gross profit ratio (GPR), operating profit margin (OPM), and return on total assets (ROTA).

Significance of the Study

The relationship between Working Capital Management and Performance of manufacturing sector small and medium sized enterprises has not been studied in Nigeria. Therefore, it will contribute to fill the gap in knowledge. The relationship between Working Capital management and Profitability of firms has been studied in other countries. By their numbers alone, SMEs and entrepreneurial firms are a key segment and driver for most (if not all) national economies. Understanding how SMEs achieve high performance has significant implications for SME owners/managers, SME employees, and the economies in which the SME operates. High level of performance can facilitate firm growth and subsequent profit performance, which in turn can yield employment gains and contribute to the general economic health of a state, region, or nation. Conversely, low performance may lead to firm stagnation or failure, and the negative economic ramifications commensurate with these outcomes. Therefore, understanding the relation between proper working capital management and performance of SMEs is vital important to the SME sector.

Literature Review

Managers can increase corporate profitability by reducing the number of days accounts receivable and inventories. Less profitable firms wait longer to pay their bills (Deloof, 2000). Small companies focus only on working capital management where they expect to improve marginal returns (Howorth and Westhead, 2003). In firms of all sizes, a basic aim of management accounting routines is to control vital areas and to monitor, and hopefully improve, performance (Emmanuel et al., 1990; Dent, 1996). Small firms need to particularly control and monitor their working capital. This is because they are generally associated with a higher proportion of current assets relative to large firms, less liquidity, volatile cash flows, and a reliance on short term debt (Peel et al., 2000). Smaller firms should adopt formal working capital management routines in order to reduce the probability of business closure, as well as to enhance business performance (Peel and Wilson, 1996). Most companies in Sri Lanka have informal working capital policy. The managing director plays a major role in formulating formal or informal policy. Company profitability and working capital policy influence the payable management and working capital finance respectively.

Company profitability has an influence on the methods of working capital planning and control. Material requirement planning (MRP) and perpetual inventory control (PIC) system are key techniques of inventory management. Most of the companies take cash discounts, but their annual cost of working capital funds is high that ranges between 15- 20% (Pandy and Perera,

1997). Firms may have an optimal level of working capital that maximizes their value. On the one hand, large inventory and a generous trade credit policy may lead to high sales. Larger inventory reduces the risk of a stock-out. Trade credit may stimulate sales because it allows customers to assess product quality before paying (Long, Malitz and Ravid, 1993; Deloof and Jegers, 1996). Suppliers may have significant cost advantages over financial institutions in providing credit to their customers; it can also be an inexpensive source of credit for customers (Petersen and Rajan, 1997). A Popular measure of WCM is the cash conversion cycle, i.e. the time lag between the expenditure for the purchases of raw materials and the collection of sales of finished goods. The longer this time lag, the larger the investment in working capital. A longer cash conversion cycle increases profitability because it leads to higher sales. However, corporate profitability also decreases with cash conversion cycle, if the costs of higher investment in working capital rise faster than the benefits of holding more inventories and/or granting more trade credit to customers (Deloof, 2000). Shin and Soenen (1998) investigate the relation between a measure of the cash conversion cycle and corporate profitability. They found a strong negative relation. This result indicates that managers can create value for their shareholders by reducing the cash conversion cycle to a reasonable minimum. Small firms need to particularly control and monitor their working capital. This is because they are associated with a higher proportion of current assets relative to large firms, less liquidity, volatile cash flows, and a reliance on short term debt (Peel et al., 2000). Deloof (2000) finds that Managers can increase corporate profitability by reducing the number of day's accounts receivables and inventories and less profitable firms wait longer to pay their bills. Firms may have an optimal level of working capital that maximizes their value. On the one hand, large inventory and a generous trade credit policy may lead to higher sales. Large inventory reduces the risk of a stock out. Trade credit may stimulate sales because it allows customers to assess product quality before paying (Long, Malitz, and Ravid, 1993; Deloof and Jegers, 1996). Because suppliers may have significant cost advantages over financial institutions in providing credit to their customers, it can also be an inexpensive source of credit for customers (Petersen and Rajan, 1997). Efficient Working Capital management is an integral part of the overall corporate strategy to create shareholder value. Shin and Soenen (1998) investigate the relation between the firm's net trade cycle and its profitability. Two authors find a strong negative relation between the length of the firm's net trade cycle and profitability.

In addition, shorter net trade cycles are associated with higher risk adjusted stock returns. The way in which working capital is managed can have a significant impact on both the liquidity and profitability of the company. Smith (1980) first signaled the importance of trade-offs between the dual goals of working capital management, i.e., liquidity and profitability. In other words, decisions that tend to maximize profitability tend not to maximize the chances of adequate liquidity. Conversely, focusing almost entirely on liquidity will tend to reduce the potential profitability of the company. A well designed and implemented working capital management is expected to contribute positively to the creation of a firm's value (Padachi, 2006). Given their vulnerability to a fluctuation in the level of working capital, they cannot afford to starve of cash. The study undertaken by (Peel et al., 2000) revealed that small firms tend to have a relatively high proportion of current assets, less liquidity, exhibit volatile cash flows, and a high reliance on short-term debt. For small and growing businesses, an efficient working capital management is a vital component of success and survival; i.e. both profitability and liquidity (Peel and Wilson, 1996).

They further assert that smaller firms should adopt formal working capital management routines in order to reduce the probability of business closure, as well as to enhance business performance. Given these peculiarities, Peel and Wilson (1996) have stressed the efficient management of working capital, and more recently good credit management practice as being pivotal to the health and performance of the small firm sector. Along the same line, Berry et al (2002) finds that SMEs have not developed their financial management practices to any great extent and they conclude that owner- managers should be made aware of the importance and benefits that can accrue from improved financial management practices. The study conducted by De Chazal Du Mee (1998) revealed that 60% enterprises suffer from cash flow problems. Narasimhan and Murty (2001) stress on the need for many industries to improve their return on capital employed (ROCE) by focusing on some critical areas such as cost containment, reducing investment in working capital and improving working capital efficiency. Working capital management is important because of its effects on the firm's profitability and risk, and consequently its value (Smith, 1980). On the one hand, maintaining high inventory levels reduces the cost of possible interruptions in the production process or loss of business due to the scarcity of products, reduces supply costs, and protects against price fluctuations, among other advantages (Blinder and Manccini, 1991). On the other, granting trade credit favors the firm's sales in various ways. Trade credit can act as an effective price cut (Brennan, Maksimovic and Zechner, 1988; Petersen and Rajan, 1997), incentives customers to acquire merchandise at times of low demand (Emery, 1987), allows customers to check that the merchandise they receive is as agreed (quantity and quality) and to ensure that the services contracted are carried out (Smith, 1987), and helps firms to strengthen long- term relationships with their customers (Ng, Smith and Smith, 1999). Some previous studies have used this measure to analyze whether shortening the cash conversion cycle has positive or negative effects on the firm's profitability.

Specifically, Shin and Soenen (1998) analyze the relation between the cash conversion cycle and profitability for a sample of firms listed on the US stock exchange during the period 1974- 1994. Their results show that reducing the cash conversion cycle to a reasonable extent increases firms' profitability. These previous studies have focused their analysis on larger firms. However, the management of current assets and liabilities is particularly important in the case of small and medium- sized companies. Most of these companies' assets are in the form of current assets. Also, current liabilities are one of their main sources of external finance in view of their difficulties in obtaining funding in the long- term capital markets (Petersen and Rajan, 1997) and the financing constraints that they face (Whited, 1992; Fazzari and Petersen, 1993). In this respect, Elliehausen and Woken (1993), Petersen and Rajan (1997) and Danielson and Scott (2000) show that small and medium- sized US firms use vendor financing when they have run out of debt. Thus, efficient working capital management is particularly important for smaller companies (Peel and Wilson, 1996).

According to empirical research that has been done, most of them identified the importance of working capital management for the survival and growth of the business enterprises. According to Dellof (2000) managers can increase corporate profitability by reducing the number of day's accounts receivable and inventories. According to Peel and Wilson (1996) smaller firms should adopt formal working capital management routines in order to reduce the probability of

business closure, as well as to enhance business performance. Research about working management in Sri Lanka was not available. But Pandey and Perera, (1997) has done a study on working capital management practices and identified that most companies in Sri Lanka have informal working capital policy. Shin and Soenen (1998) investigated a strong negative relation between cash conversion cycle and corporate profitability and the result indicates that managers can create value for their shareholders by reducing the cash conversion cycle to a reasonable minimum.

Methodology

A structured questionnaire was used to collect data from SMEs. The researcher used the random sampling and collected data from 30 small and medium sized enterprises. Correlation analysis, regression analysis and descriptive statistics calculations were done using Statistical Package for Social Sciences (SPSS). Using the Correlation analysis, correlation between working capital management indicators and profitability indicators were found. Regression analysis used to identify the impact of working capital management on profitability. Finally the results were discussed and recommendations which can be applied to improve the profitability of SME sector were made.

Conceptual Framework

Working capital management has identified as independent variable while profitability of the manufacturing sector SME was the dependent variable. Inventory days, accounts receivable days, accounts payable days and cash conversion cycle has identified as indicators of working capital management and gross profit ratio, operating profit margin and return on total assets has identified as indicators of profitability. When there are a less number of inventory days, and a less number of accounts receivable days and higher number of accounts payable days, it says that there is a good cash conversion cycle. A good cash conversion cycle indicates proper working capital management.

According to literature since there is a negative relation between proper working capital management and profitability, a shorter cash conversion cycle finally leads to higher performance in small and medium enterprises.

Hypotheses

H₁: Shorter stock period increases the profitability of manufacturing sector small and medium sized enterprises

H₂: Shorter accounts receivable period enhances the profitability of manufacturing sector small and medium sized enterprises

H₃: Longer accounts payable period increases the profitability of manufacturing sector small and medium sized enterprises

H₄: Shorter Cash Conversion Cycle increases the profitability of manufacturing sector small and medium sized enterprises

Variables

In order to identify the effects of working capital management on the firms' profitability, researcher used gross profit ratio (GPR), operating profit margin (OPM) and return on total assets (ROTA) as dependent variables. The gross profit ratio is calculated as

Data Collection

A structured questionnaire was used to collect data from small and medium business owners. The collection of data was difficult since unawareness about research and fear of putting information in the hands of competitors. The questionnaire gathered data on working capital management and financial performance and financial position of each enterprise. All together the researcher received 109 filled questionnaires but due to non- completion 33 questionnaires was rejected and 76 completed questionnaires were taken in to analysis.

Analysis

Descriptive statistics (mean, standard deviation, minimum, median and maximum) for all the variables were calculated for entire SME sector. Then segment wide means and standard deviations for all the variables were found. Pearson's correlation coefficients were calculated for all the variables to identify the relation between working capital management and profitability. Finally, regressions were found out using regression method to identify the impact of working capital management on profitability.

Correlation Analysis

To examine the association among the variables under consideration, including the relationship between working capital management and profitability, the Pearson's correlation coefficients were calculated. Table 1 summarizes the correlation matrix with Pearson's correlation coefficients.

Regression Analysis

The researcher used regression analysis to further investigate the association between corporate profitability [gross profit ratio (GPR) and return on total assets (ROTA)] and the indicators of working capital management. The determinants of the corporate profitability are estimated with regression model.

Findings

Table 1 presents Pearson's correlation coefficients for all the variables under the research. Gross profit ratio (GPR) indicated a significant positive relation of 0.309 with inventory days (ID). The relation between GPR and accounts receivable days (ARD) was negative 0.157 and significant. GPR positively and significantly related with accounts payable days (APD) at a value of 0.142. It shows GPR positively but not significantly related with cash conversion cycle (CCC) at the value of 0.089.

There was a non-significant negative relation of 0.082 between the operating profit margin (OPM) and inventory days (ID). Also OPM significantly and negatively related with ARD at a value of 0.404. But there was a positive relation of 0.074 between OPM and APD and this was

not significant. Again there was a negative and significant relation of 0.210 between OPM and CCC. Return on total assets (ROTA) and ID related negatively at the value of 0.067 (not significant). There was a negative and significant relation of 0.141 between ROTA and ARD. APD related with a negative value of 0.058 with ROTA and this was not significant. CCC related at 0.031 with the ROTA (relation was not significant). ROTA was negatively correlated with all the measures of WCM.

Accounts receivable days (ARD) strengthen the negative relation between working capital management (WCM) and profitability by ensuring negative and significant relations with all the profitability measures GPR, OPM, and ROTA. ID positively and significantly correlated with other working capital management indicators ARD, APD and CCC. Also ARD positively and significantly correlated with the WCM indicators of APD and CCC. APD negatively and significantly correlated with CCC. Total debt capital to total capital (gearing ratio) showed inverse and significant relationships with profitability ratios OPM and ROTA.

The relation between gearing ratio and GPR was negative but not significant. Gearing ratio showed negative and significant relations of 0.169 and 0.169 with OPM and ROTA respectively. This indicates that when the proportion of debt capital in the total capital increases, the profitability of the enterprises decreases. Also there was a positive relation of 0.074 (not significant) between gearing ratio and CCC. Current ratio (CR) showed negative relations with GPR and OPM at the values of 0.136 and 0.070 (only - 0.136 was significant) but positively correlated with ROTA at 0.100 (not significant).

Discussion

Gross profit ratio (GPR) indicated a significant and positive relation of 0.309 with inventory days (ID). This indicates that gross profit is high when stock holding period is high. This is true for the gross profit since all the costs relating to the stocks (other than purchasing costs) generally write off to the profit and loss account. Therefore, when it comes to the profit and loss account, the profitability showed a negative relation (but not significant) with inventory days since it considers all the other costs of holding inventory.

The relation between GPR and accounts receivable days (ARD) was negative 0.157 (significant at 0.017). This indicated manufacturing sector small and medium sized enterprises can increase their gross profit by reducing the number of accounts receivable days (ARD). In other words SMEs can increase profitability by collecting cash from debtors within a short period of time. Again GPR positively related with accounts payable days (APD) at significant level of 0.032. It says that SMEs can increase their gross profit by delaying payments to suppliers. Positive relation between cash conversion cycle (CCC) and gross profit (GP) does not indicate that SMEs can increase their gross profit by increasing the duration of CCC since the relation was not significant and which cannot be true in the practical business world. There was a negative relation between the operating profit margin (OPM) and inventory days (ID). Since it was not significant, this result does not indicate higher inventory days (ID) leads to less profitability. Significant negative relation between OPM and ARD indicated that profitability of the SME manufacturing sector is low when the ARD is high. Therefore, managers should collect from

debtors within short periods of time to increase the profitability. Return on total assets (ROTA) and ID related negatively at the value of 0.067 but the relation was not significant. There was a negative significant relation between ROTA and ARD. This negative relation indicates managers can increase return on total assets by collecting from debtors within a short period of time. APD related with a negative value of 0.058 with ROTA but it was not significant. CCC related at 0.031 with the ROTA but this relation was also not significant. ROTA was negatively correlated with all the measures of WCM but only the relation with ARD was significant. Total debt capital to total capital (gearing ratio) showed inverse relationships with all the profitability ratios GPR, OPM and ROTA (only the relation with GPR was not significant). This indicates that when the proportion of debt capital in the total capital increases, the profitability of the enterprises decreases. The reason for this is the cost of the debt capital is higher than the gain generated through the utilization of this debt capital. Also there was a positive relation between gearing ratio and CCC but it was not significant. Current ratio (CR) showed a significant negative relation with GPR.

This indicates a negative impact of gearing on profitability. This finding is in support of Myers and Majluf (1984) and Rajan and Zingales' (1995) results predicting a negative relationship between profitability and leverage. The impact of CL/TL on ROTA showed a negative relation at higher significant level. It says when the portion of current liability (CL) in the total liability (TL) is high; it leads to decrease the profitability in the SME sector.

Conclusion

Gross profit ratio (GPR) indicated positive relations with inventory days (ID), accounts payable days (APD) and cash conversion cycle (CCC), but it is not recommended for the manufacturing sector small and medium enterprises to have high inventory days and longer cash conversion cycles since the other costs involve with the longer ID and CCC affect to the operating profit margin (OPM) and return on total assets (ROTA). Also it is not recommended to apply the positive relation between GPR and APD since it does not further facilitate from the regression analysis. Researcher recommends applying the negative relation between GPR and accounts receivable days (ARD) since when SMEs collect money from debtors within a short period of time it leads to increase the gross profit, operating profit and return on total assets of the manufacturing sector enterprises. The measure of accounts receivable policy (ARD) impacted negatively on GPR. This indicates increase of 1 day in ARD leads to decrease gross profit by 0.1 percent. Therefore, it is recommended to decrease ARD to a minimum possible level. The negative relation between OPM and ID indicated higher inventory days leads to less profitability but the relation is not significant. Therefore, it was not recommended to apply the negative relation between ID and OPM. Negative relation between OPM and ARD indicates that profitability of the SME manufacturing sector is low when the ARD is high. Therefore, it is recommended that managers try to collect from debtors within short periods of time to increase the profitability.

Recommendations

The positive relation between OPM and APD does not recommend apply since the relation is not significant. Negative relation between OPM and CCC indicates profitability is high when the

number of days in CCC is low. But this result does not support from the regression analysis. Therefore, it does not recommend applying the negative relation between CCC and OPM. Return on total assets (ROTA) and ID related negatively and this does not indicate that ROTA is high when the manufacturing sector SMEs ID is low since it is not significant. Also it did not support from the regression analysis. Therefore, it is not recommended to apply negative relation between ID and ROTA. The negative relation between ROTA and ARD indicates managers can increase return on total assets by collecting from debtors within a short period of time. Hence, it is recommended to collect the dues from debtors within possible minimum periods of time. Accounts receivable policy was shown an inverse impact on return on total assets (ROTA). Regression results indicate when ARD increase by 1 day ROTA decrease by 0.1 percent. Since there is a decrease in ROTA as a result of increase in ARD, it is recommended to decrease ARD to a minimum possible level without affecting the customer relations. The negative relation between CCC and ROTA was not significant. It shows the impact of CCC on GPR and ROTA almost equal to zero. Therefore, it does not recommend reducing CCC to a minimum possible period. Inverse relation between gearing ratio and profitability ratios indicated that the profitability is less when the proportion of debt capital in the total capital is high. The reason for this is the cost of the debt capital is higher than the gain generated through the utilization of this debt capital. The regression analysis also ensured the inverse impact of gearing on profitability. Therefore, it is recommended to decrease the proportion of debt capital in the total capital or to find out alternative debt capital sources at lesser cost than the cost of existing debt capital. Negative relation between Current ratio and GPR was significant. But the negative relation between CR and OPM was not significant. The impact of CR on ROTA is zero. Therefore, it does not recommend applying the negative relation between CR and profitability. Quick assets (QAR) ratio showed negative relations with GPR and OPM. These negative relations indicate profitability is high when QAR is low. Therefore, it is recommended to maintain low level of QAR. Ratio of stocks to current assets (STK/CA) correlated positively with GPR, OPM and ROTA. This indicates profitability is high when proportion of stocks is high in the total current assets. Therefore, it is recommended to have higher proportion of stocks in the current assets. The negative relation between the ratio of total assets to current assets (CA/TA) and GPR indicates profitability is high when the proportion of current assets is less in the total assets. Further the negative relation between CA/TA and ROTA indicates the same results. When the current assets are high the related costs also high and as a consequence profitability is less. Therefore, it is recommended to reduce the proportion of CA in the TA to a minimum possible level. The positive relation between gross working capital efficiency ratio (Sales/CA) and profitability ratios indicated profitability is high when the efficiency ratio is high. Therefore, it is recommended to increase the ratio of CA turning to sales. The negative relations of SALES/CA and ID, ARD, APD and CCC indicated when the efficiency is high, it leads to reduce the ID, ARD, APD and CCC. The reduction ARD helps to increase the profitability of the enterprises. Since SALES/CA ratio leads to improve the working capital management of the organizations, it is recommended to improve SALES/CA ratio to the maximum possible level.

Researcher concludes with the suggestion that there is a pressing need for further empirical studies to be undertaken on small and medium business financial management, in particular their working capital practices by extending the sample size so that an industry- wide analysis

can help to uncover the factors that explain the better performance for some industries and how these best practices could be extended to the other industries. This would also assist policy- makers and educational institutions to identify the requirements of, and specific problems faced by small and medium firms in Sri Lanka, especially as more emphasis is placed on the sector by the government.

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