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# Effects of Accounts Payable Management on the Performance of Small and Medium Enterprises (SMEs) in Nigeria

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Abstract
Accounts Payable Management which is one of the components of Working capital management is expected to enhance the performance of enterprises and by extension, the share holder's value. The relation between Accounts Payable Management and performance was investigated for a sample of 211 small and medium sized enterprises in Kaduna North and South Local Government Areas of Kaduna Nigeria for the period 2008-2012. The Accounts Payable Management was used as the independent variable while Performance of SMEs was considered as the dependent variable. Correlation coefficients and Regression analysis were used as measures of the relations. The Accounts Payable Management showed significant positive relations with Performance of SMEs. The Regression results rejected the null hypothesis that cash management does not affect the performance of SMEs. It (regression results) however, ensured the positive relation between cash management and performance measures of Small and Medium Enterprises (SMEs).

Keywords: *Accounts Payable Management, Performance, Small and Medium Enterprises*

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## Background to the Study

Accounts payable are one of the major sources of unsecured short-term financing (Gitman), 2009; Hill & Sartoris, 1992). Utilizing the value of relationship with payee is a sound objective that should be highlighted as important as having the optimal level of inventories (Hill & Sartoris, 1992). As a consequence, strong alliance between company and its suppliers strategically improve production lines and strengthen credit record for future expansion. Gitman (2009) and Birt et al., (2011) stated that Accounts Payable Management objective is to pay creditors as slowly as possible without damaging its credit rating. Accounts Payable and accruals are the two major spontaneous liability sources of short-term financing for a typical firm.

Accounts Payables are the major unsecured short-term financing for businesses. They result from transactions in which merchandise (inventory) is purchased. The suppliers might give credit terms together with allowing discount to the purchasers. Western and Copeland (1989) made reference to trade credit as the largest category of short-term credit, representing about one-third of the current liabilities of non-financial corporation. Firms must have policies concerning those who authorize purchasing, and how purchasing is geared to demand which can lead to proper management of accounts payable. Belt (1979) observed that accounts payable are more deferrable in that the average payment can be extended by managerial decision. However, this deferability is limited to an unknown extent; eventually, supplier will refuse to seal firms that excessively delay payment.

Current liabilities are one of their (SMEs) 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 Whitley, (1992); Fazzari and Petersen, (1993). In this respect, Elliehausen and Woken (1993), Danielson and Scott (2000) observed that small and medium-sized US firms use vendor financing when they have run out of debt. Thus Peel and Wilson, (1996) argued that, efficient working capital management is particularly important for smaller companies .

Based on the above background, the study was designed to assess the effect of Accounts Payable Management on the Performances of Small and Medium Enterprises in Nigeria. The study was anchored on the specific objective as stated under. To establish the effect of Accounts Payable Management on the Performances of Small and Medium Enterprises in Kaduna North and South Local Government areas of Kaduna State Nigeria.

## Literature Review

According to empirical research that has been done, most have identified working capital Management as critical for the survival and growth of the business enterprises. Azam M. Haider S.I. (2011) investigated the impact of Working Capital management on firms' performance for non- financial institutes listed in Karachi Stock Exchange (KSE-30) Index. Panel data have been analyzed by applying Canonical correlation for the time period of 2001 to 2010. APP is found to have a significantly positive association with ROA

and ROE indicating that if time period of supplier's payment is increased then overall firm's performance also improves. CCC and NTC shows significant negative relation ROA and ROE showing that firms' performance can be increased with short size of both of them.

Another attempt to explore the relationship between the variables of Working Capital Management and Profitability was made by Haitham Nobanee and Maryam AlHajjar. Their analysis was based on a sample containing 2123 Japanese non-financial firms listed in the Tokyo Stock Exchange for the period from 1990 to 2004. The authors, after analyzing the results, suggested that Japanese firms should focus on shortening their Receivable Collection Period, Inventory Conversion Period and Cash Conversion Cycle to enhance profitability. Lengthening the Payable Deferral Period could also add to profitability, they argued. However, they deemed the over lengthening of the Payable Deferral Period to be equally risky as it could harm the firm's credibility and credit reputation in the long run.

The study of Binti Mohamad and Mohd Saad (2010) was based on secondary data of 172 firms of Malaysia. They evaluated the impact of various components of working capital on profitability and market value of the firms. The study covered a time span of five years from 2003 to 2007. For this purpose they used different working capital components namely cash conversion cycles (CCC), debt ratio (DR), current assets to total assets ratio (CATAR), current liabilities to total assets ratio (CLTAR)and current ratio (CR),. To see the effect of these working capital components on financial performance they used Tobin's Q (TQ), return on invested capital (ROIC) and return on assets (ROA) as a measurement of financial performance of the selected firms. To deduce the results they used correlations and multiple regression analysis. The results showed that there exists an inverse relationship between different working capital components and performance of firms.

The empirical study of Lakshan (2009) who investigated the effects of working capital management on sampled Srilankan firm revealed a positive relationship between gross profit ratio and accounts payable so also is the study of Hill, Sartoris and Ferguson (1983) which revealed that the vast majority of firms generally take the discount for credit purchase and also expressing the view that, efficiency in working capital management requires a firm to make use of credit terms extended to it, balancing such with favorable trade-offs for early payments from customers with discounts negates these findings.

The impact of working capital management on profitability was also observed by Cote and Latham (1999) who discovered that management of inventory, receivables and payables had a direct influence on a company's Cash Flows which could ultimately affect its profitability.

Marc Deloof investigated the relationship between working capital management and profitability for a sample of large-sized Belgian firms during the period 1992-1996. He observed that profitability could be enhanced by reducing the Receivable Collection

Period and the Inventory Conversion Period. The increase in corporate profitability due to reduction in Payable Deferral Period was explained by him as less lucrative entities would tend to delay imbursement of their outstanding liabilities.

## Conceptual Framework

Accounts Payable Management has been identified as independent variable while performance which include (profitability, growth in sales, return on assets and return on equity) of the small and medium enterprises (SMEs) was the dependent variable. A good accounts payable management indicates proper working capital management also, meaning that an optimum accounts payable management finally leads to higher Performance in Small and Medium Enterprises.

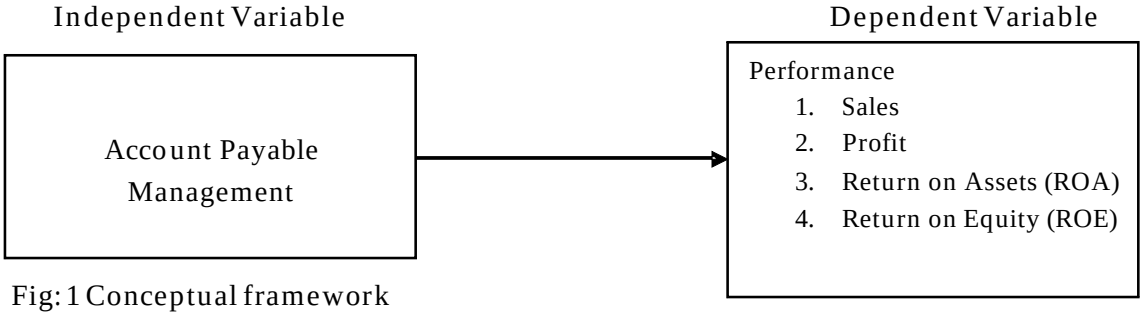


Fig: 1 Conceptual framework

## Methodology

The research used both qualitative and quantitative tools for analyzing data. In effect the research was carried out by employing data collection techniques including questioners and interviews as advocated by Curran and Blackborn (2001) where they averred that a single study may use qualitative and quantitative techniques and procedures as well as primary and secondary data. The data was analyzed using descriptive statistics; weighted average, mean and standard deviation. Regression Analysis which shows the relationship between the variables (Accounts Payable Managements and Performance) was used. Simple linear regression with the formula y=a+bx where a & b are the regression coefficient, y=slope of the line and x=the intercept was then used to determine and quantify the relationship between the variables (Accounts Payable Management and Performance of SMEs). The Performance Model adopted for this study was as summarized below.

$FP = \beta_0 + \beta_{1pm} + e$ where β0 and $\beta_{1pm}$ *are coefficient and e=Error Variable. PM=Payable Management P=Performance*

## Results and Discussions

The study sought to investigate if Accounts Payable management affects the performance of Small and Medium enterprises in (SMEs) Nigeria. Table 1.1 presents the frequency and percentage distribution of the findings on the independent variable, (Accounts Payable). A closer look at table 1.1 shows that a majority of the respondents which represents 53.9% and 63.2% for accounts payable policy and accounts payable

monitoring respectively stated the yes answer while 43.2% answered yes to achieving optimum level of managing accounts payable.

The above finding falls in line with the view expressed by Helfert and Scott (2003) that efficiency in credit management ensures that a firm is able to pay its bills on time and carry sufficient stocks. Trade credit from suppliers and accounts payable they further added helps offset receivables and inventories. It also concurred with the findings of N. Hill, W. Sartoris and D. Ferguson (1998) which revealed that the vast majority of firms generally take the discount. In deciding whether to take the discount, the primary criterion of most firms is the amount of the discount. This makes good financial sense, since the amount of discount (along with the delay period from the discount date to the due date) determines the cost of skipping as a source of financing. The other financing strategy in connection with accounts payable is the stretching of payables beyond the due date. Hill, Sartoris and Ferguson's (1998) survey revealed three important factors that are considered by firms in deciding whether to use this strategy; the value of using the funds (that is the cost of the funds relative to other funding sources), the effects on relationships with supplies and the impact on the firm's credit rating.

Table 1.1: Descriptive analysis of the items in the questionnaire

| Item | No | | Yes | | Average | Average response |
|---|---|---|---|---|---|---|
| | F | % | F | % | | |
| Does your firm have accounts payable management policy? | 86 | 46.1 | 100 | 53.9 | .5392 | Yes |
| Is the periodicity of account payable being monitored? | 68 | 36.8 | 118 | 63.2 | .6316 | Yes |
| Is optimality of account payable management being achieved? | 106 | 56.8 | 80 | 43.2 | .4316 | No |

Sections 1.1 to 1.3 present findings on each of the specific question which was used in obtaining information on this variable.

Gitman (2009) and Birt et al., (2011) averred that Accounts Payable Management objective is to pay creditors as slowly as possible without damaging its credit rating. Accounts Payable and accruals he maintained are the two major spontaneous liability sources of short-term financing for a typical firm and that they are the major unsecured short-term financing for businesses. They result from transactions in which merchandise (inventory) is purchased.

Table 1.1 revealed 53.9% of the respondents have accounts payable management policy while 43.1% answered the opposite indicating that majority of the SMEs in research area do have the policy in managing their accounts payable. This finding concurred with the view of Gitman (2009) who averred that the suppliers might give credit terms together with allowing discount to the purchasers and that estimate of credit risk associated with the buyer will indicate what credit policy is to be adopted. This risk may be with reference

to buyer's financial standing or with reference to the nature of the business the buyer is in. Cash discount influences the effective length of credit he further stated.

The view as expressed above concurred with that of Western and Copeland (1989) who made reference to trade credit as the largest category of short-term credit, representing about one-third of the current liabilities of non-financial corporation and that firms must have policies concerning those who authorize purchasing, and how purchasing is geared to demand. This can lead to proper management of accounts payable they further opined.

Whether periodicity of accounts payable is being monitored

Accounts payable, a form of working capital finance, should be maximally used by firms. Helfert, (2003) suggested the exceeding of normal credit terms deliberately, making interest pay off more favorable; cautioning however, of the risk of affecting the company's credit standing if delays beyond the credit terms granted, become habitual. Table 1.1 reveals that 63.2% of the respondents do monitor their accounts payable management while 36.8% do not indicating that a majority of the SMEs in Kaduna North and South Local Governments monitored the period and the volume of obligations including the period when it will fall due. The finding above agrees with the view of Helfert (2003) who averred that sound management of suppliers' credit, requires current up-to-date information on accounts and aging of payables to ensure proper payments. To forestall adverse effects of credit on firm operators, he added, working capital efficiency require constant updating of credit performance, and developing sound criteria for credit extension.

On whether optimality is being achieved

Table 1.1 reveals that only 43.2% of respondents achieve the optimum in the management of accounts payable management while 56.8% doesn't indicating that majority of SMEs do not achieve optimum management of their payables.

The above findings are in contrast with the view expressed by Hill and Sartoris (1992) that utilizing the value of relationship with payee is a sound objective that should be highlighted as important as having the optimal level of inventories and as a consequence, strong alliance between company and its suppliers strategically improve production lines and strengthen credit record for future expansion. The empirical findings of Lakshan (2009) who investigated the effects of working capital management on sampled Srilankan firm and which revealed a positive relationship between gross profit ratio and accounts payable and also that of Hill, Sartoris and Ferguson (1983) which revealed that the vast majority of firms generally take the discount for credit purchase and also expressing the view that, efficiency in working capital management requires a firm to make use of credit terms extended to it, balancing such with favorable trade-offs for early payments from customers with discounts however, negates these findings.

Regression Analysis for Accounts Payable

Regression Analysis was carried out on Accounts Payable Management via hypothesis 3 below to determine whether the independent variable can be relied on in explaining the change in the dependent variable, performance of Small and Medium Enterprise (SMEs) in Nigeria.

Hypothesis 3: the null hypothesis that working capital management (Account payable) does not have a significant effect on the performance of Small and Medium Enterprises in Nigeria is tested at 5% level of significant using linear regression analysis.

Table 4.9: Table of regression analysis

Coefficients[a]

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 77.497 | 6.726 | | 11.523 | .000 |
| | Accounts Payable Management | 24.060 | 11.150 | .211 | 2.158 | .033 |

a. Dependent Variable: Performance of SMPE, $R^2 = .044$, $R = 0.210$

$Y = 77.497 + 24.060*x$

The above analysis shows that the value of the correlation R = 0.210, implying that there is 21% linear relationship between the accounts payable management and performance of SME. The coefficient of determination (R2) of 0.044 or 4.4% suggests that Accounts Payable Management can explain up to 4.4% of the change in performance.

The p-value (0.033) of the slope of the regression model is less than 0.05 we therefore reject $H_0$ and conclude that working capital management (Accounts Payable) have a significant effect on the performance of Small and Medium Enterprises in Nigeria. This also means that at 5% level of significance or 95% level of confidence, Accounts Payable Management plays a significant role in the performance of Small and Medium Enterprises in Nigeria and that the model is statistically significant in explaining the change in the dependent variable (performance) considering that the *P-value* is less than .05 at the 95% level of confidence.

The above finding underscores the views of Petersen and Rajan, (1997); Whitley, 1992; Fazzari and Petersen, (1993) Peels and Wilson (1996) that, Current liabilities are one of Small and Medium Enterprises (SMEs) main sources of external finance in view of their difficulties in obtaining funding in the long-term capital markets and the financing constraints that they face, thus, efficient working capital management is particularly important for smaller companies. It is also in agreement with assertion of Hill & Sartoris, (1992) that, utilizing the value of relationship with payee is a sound objective that should be highlighted as important as having the optimal level of inventories and as a

consequence therefore, strong alliance between company and its suppliers strategically improve production lines and strengthen credit record for future expansion.

The argument of Deloof (2000), Lasher (2008) further concurred with the above views when they stated that on the liabilities side, postponing payment to suppliers lets a firm to get the goods prior to paying, therefore increases spontaneous financing and thus reduces the need for costly external funding. It is also in conformity with the argument of Gitman (2009) and Birt et al., (2011) who stated that Accounts Payable Management objective is to pay creditors as slowly as possible without damaging its credit rating.

The empirical results arising from the study of some researchers agrees and strengthens the above findings. 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. Among the researchers whose findings agreed with the findings of this study are, Azam M. Haider S.I. (2011) who investigated the impact of Working Capital management on firms' performance for non- financial institutes listed in Karachi Stock Exchange (KSE-30) Index. Their research indicated that Accounts Pay Period (APP) is found to be significant positive association with Return on Assets (ROA) and Return on Equity (ROE) indicating that if time period of supplier's payment is increased then overall firm's performance also improves. It also agrees with the findings by Cote and Latham (1999) who discovered that management of inventory, receivables and payables had a direct influence on a company's Cash Flows which could ultimately affect its profitability.

Mathuva (2009) studied the impact of working capital management on the performance. He took almost 30 listed firms as a sample and all these companies were listed in Nairobi stock exchange and the data was taken from 1993 to 2008. Among the assumptions of the research was the association between the average payment period and profitability and was found out to be positive ($p<0.01$). Another attempt to explore the relationship between the variables of Working Capital Management and Profitability was made by Haitham Nobanee and Maryam AlHajjar (2009) whose results, suggested that Japanese firms should focus on shortening their Receivable Collection Period, Inventory Conversion Period and Cash Conversion Cycle to enhance profitability. Lengthening the Payable Deferral Period could also add to profitability, they argued. However, they deemed the over lengthening of the Payable Deferral Period to be equally risky as it could harm the firm's credibility and credit reputation in the long run.

Filbeck G. et al. (2005) investigated the data of 26 industries by taking the data of 970 companies during 1996 to 1999. They found out that firms are able to decrease financing cost and / or augment the funds obtainable for development by reducing the amount of funds attached to the current assets. They revealed that significant difference exist between industries in working capital measures across time. It is concluded that negative relationship was also found out between profitability and liquidity of companies of United Kingdom. Conversely a positive relationship was seen between debt and firm's

profitability. The researchers propose that profitability can be increase by managers if reduction in the days of accounts receivable and inventories occurred. Therefore the companies whose profitability is less opt to take much longer time to pay their bills.

The findings of this study however contrast sharply with that of Amarjit Gill, Nahum Biger, Neil Mathur (2010) whose studies reported negative correlation of this variable (Account payable) and the profitability of the firm. They found no statistically significant relationship between these variables. Considering the value of R-square (0.165) which implies that 16.5% of the performance of SMEs in Nigeria is determined by the working capital management (inventory), this study, therefore, established that there is need to implement sound inventory management policies and monitoring systems by managers of SMEs in Nigeria so as achieve optimum results.

Summary

In this study, a majority of the respondents which represents 53.9% and 63.2% for accounts payable policy and accounts payable monitoring respectively stated a yes answer while 43.2% answered yes to achieving optimum level of managing accounts payable which falls in line with the view expressed by Helfert and Scott (2003) that efficiency in credit management ensures that a firm is able to pay its bills on time and carry sufficient stocks and that trade credit from suppliers and accounts payable they further added helps offset receivables and inventories and it also concurred with the findings of N. Hill, W. Sartoris and D. Ferguson (1998) which revealed that the vast majority of firms generally take the discount.

The analyzed data shows that the value of the correlation R = 0.210, implying that there is 21% linear relationship between the inventory management and performance of SME. The coefficient of determination (R2) of 0.044 or 4.4% suggests that Accounts Payable Management can explain up to 4.4% of the change in performance. The Analysis of this study also showed the p-value (0.033) of the slope of the regression model is less than 0.05 indicating that working capital management (Accounts Payable) has a significant effect on the performance of Small and Medium Enterprises in Nigeria and that at 5% level of significance or 95% level of confidence, Payable Management plays a significant role in the performance of Small and Medium Enterprises.

The revelation implies that the model is statistically significant in explaining the change in the dependent variable (performance), and this concurred with the views of Petersen and Rajan, (1997); Whitley, 1992; Fazzari and Petersen, (1993) Peels and Wilson (1996) that, Current liabilities are one of Small and Medium Enterprises (SMEs) main sources of external finance in view of their difficulties in obtaining funding in the long-term capital markets and the financing constraints that they face, thus, efficient working capital management is particularly important for smaller companies and the empirical findings of Azam M. Haider S.I. (2011) whose research indicated that Accounts Pay Period (APP) is found to be significant positive association with Return on Assets (ROA) and Return on Equity (ROE) indicating that if time period of supplier's payment is increased then overall firm's performance also improves.

## Conclusion

Accounts payable is one of the major sources of unsecured short-term financing resulting from transactions in which merchandise is purchased. There is therefore, the need to utilize the value of relationship with payee as a sound objective that should be highlighted as important as having the optimal level of inventories. This also calls for a strong alliance between company and its suppliers which strategically improve production lines and strengthen credit record for future expansion and also institutionalized policies concerning those who authorize purchasing, and how purchasing is geared to demand which can lead to proper management of accounts payable. Some Scholars have argued that accounts payable are more deferrable in that the average payment can be extended by managerial decision. However, this deferability is limited as supplier may eventually refuse to seal a deal with firms that excessively delay payment. Current liabilities being accounts payable are one of main sources of external finance for SMEs in view of their difficulties in obtaining funding in the long-term capital markets and the financing constraints that they face hence, efficient and effective working capital management is particularly important for them.

## Recommendation

Base on the findings from the analyzed data which showed that 53.9% of the respondents have accounts payable management policy and also indicating that majority of the SMEs in research area do have the policy in managing their accounts payable coupled with the regression and correlation analysis which shows that the value of the correlation R = 0.210, p-value, 0.033 and the correlation coefficient of 0.044, the study recommended that these policies should continue to be monitored for continued positive results and in addition to this, information on accounts payables should continue to be updated as a reminder to ensure prompt payments for bills when due eliminating additional financial costs.

The SMEs should utilize the value of relationship with suppliers and develop strong alliance which strategically improve production lines and strengthen credit record for future expansion. The negotiation of discounts, target market and system should also be taken into account in order to improve their cash flows. They should also develop policies concerning those who authorize purchasing and how purchasing is geared to demand which can enhance proper management of accounts payable. Since Account Payables analysis is more complex than that of Accounts Receivables because it relates to both cost of sales and to expenses, to analyze it more accurately, the management accounting team should look at the inventory purchases instead of cost of sales and expenses excluding salaries and wages.

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