**THE INFLUENCE OF WORKING CAPITAL MANAGEMENT ON PROFITABILITY OF AN ORGANIZATION.**

**A CASE STUDY: MOVIT COMPANY LIMITED**

**A DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A BACHELORS DEGREE OF BUSINESS ADMINISTRATION AND MANAGEMENT.**

**UGANDA MARTYRS UNIVERSITY**

**BY**

**BAKKABULINDI MWAZI JAMES**

**REG NO. 2014-B022-20005**

**MAY 2017**

## DEDICATION

This research project is dedicated to my loving parents who have worked tirelessly to make sure I get quality education.

## ACKNOWLEDGEMENTS

This research project in its present form has been made possible by God and a number of people to whom I am greatly indebted and to whom I would like to express my gratitude.

To my supervisor Sr. Andiru Caroline; I extend my sincere gratitude for her guidance, suggestions, corrections, criticisms, patience and her continuous encouragement throughout the period of writing this research proposal.

To my family; I extend my heartfelt gratitude to my mother for her continuous prayers and encouragement, my father for encouraging me to believe in myself and my sisters and brothers for their constant encouragement.

I cannot forget to mention and thank Bro. Joseph Mary Kanaabi Zziwa. “He has not left any stone unturned in my academic life.” For all the financial, material and moral support given to me throughout the course, may the Lord reward you abundantly.

To my friends; Namyalo Allen, Ssebaggala Joseph, Kafeero Joseph, you were a great inspiration. Thank you for believing in me more than I believed in myself. The list of friends is too long.

**TO GOD BE THE GLORY**

# TABLE OF CONTENTS

Declaration .......... i

Approval .......... ii

Dedication .......... iii

Acknowledgements .......... iv

Table of Contents .......... v

List of Figures .......... x

List of Tables .......... xi

List of Acronyms .......... xii

Abstract .......... xiii

**CHAPTER ONE** .......... 1

**GENERAL INTRODUCTION** .......... 1

1.0 Introduction .......... 1

1.1 Background of the study .......... 1

1.2 Problem Statement .......... 5

1.3 Study objectives .......... 6

1.3.1 General Objectives .......... 6

1.3.2 Specific objectives .......... 6

1.4 Research Questions .......... 6

1.5 Scope of the study .......... 7

1.5.1 Subject scope .......... 7

1.5.2 Geographical scope .......... 7

1.5.3 Time scope .......... 7

1.7 Justification of the study .......... 8

1.8 Conceptual framework........9
1.9 Definition of key terms........10
1.10 Conclusion........11
**CHAPTER TWO**........12
**LITERATURE REVIEW**........12
2.0 Introduction........12
2.1 Conceptual Review........12
2.1.1 Working Capital Management........12
2.1.2 Profitability........13
2.2 Theoretical review........14
2.2.1 Agency Theory........15
2.2.2 Operating Cycle Theory........17
2.2.3 Cash Conversion Cycle Theory........17
2.3 Inventory Management and Profitability........18
2.4 Cash Management and Profitability........21
2.5 Accounts Receivables Management and profitability........23
2.6 Working capital Management and profitability........26
2.7 Intervening variables........28
2.7.1 Economic factors........28
2.7.2 Firm Size........29
2.7.3 Sales growth........31
2.8 Conclusion........32
**CHAPTER THREE**........33
**METHODOLOGY**........33
3.0 Introduction........33

3.1 Research Design....................................................................................................33

3.2 Area of the Study ....................................................................................................34

3.3 Study Population....................................................................................................34

3.4 Sample Size.............................................................................................................34

3.5 Sampling techniques ..............................................................................................35

3.5.2 Purposive sampling technique ............................................................................35

3.5 Data collection method ..........................................................................................35

3.5.1 Questionnaire .......................................................................................................35

3.5.2 Interviews.............................................................................................................36

3.5.3 Document review and analysis ...........................................................................36

3.6 Research instruments .............................................................................................36

3.7 Validity and reliability ...........................................................................................37

3.7.1 Validity ................................................................................................................37

3.7.2 Reliability.............................................................................................................37

3.8 Measurement of the variables. ...............................................................................37

3.9 Data processing and analysis ................................................................................38

3.10 Ethical issues........................................................................................................38

3.11 Limitation of the study.........................................................................................39

**CHAPTER FOUR.....................................................................................................40**

**PRESENTATION, ANALYSIS AND DISCUSSION OF THE FINDINGS ...................40**

4.0 Introduction.............................................................................................................40

4.1 Response Rate.........................................................................................................40

4.2 Background information of respondents...............................................................41

4.2.1 Gender of respondents .........................................................................................41

4.2.2: Age of respondents .............................................................................................41

4.2.3 Company department....................42
4.2.4 Duration of employment....................43
4.2.5 Level of Education....................44
4.2.6 Category of staff....................44
4.3 Findings on Working Capital Management and Profitability....................45
4.3.1 Inventory management and profitability....................45
4.3.1.1 Movit Company Limited has a computerized inventory management system....................46
4.3.1.2 The company utilizes stock taking methods....................47
4.3.1.3 The company has constant suppliers of raw materials....................47
4.3.1.4 The company has strong control methods on stock....................48
4.3.1.5 The company uses just in time purchasing system where no safety stock are kept....................48
4.3.1.6 The company has enough space for storing raw materials, goods in process and finished good....................48
4.3.2 Cash Management and Profitability....................50
4.3.2.1 Company has strong budget control systems....................50
4.3.2.2 The company is quick on recovering its debt....................51
4.3.2.3 Cash budgets are drawn for the business....................51
4.3.2.4 The company requisitions for all expense and payments to be made....................52
4.3.2.5 It is important to keep its records of cash management in the business....................52
4.3.2.6 Business keeps financial records....................52
4.3.2.7 Cash Flow is managed easily in the business....................52
4.3.3 Accounts receivables and profitability....................54
4.3.3.1 The company is good at recovering its debts....................54
4.3.3.2 The company offers cash discounts for early credit payments....................55
4.3.3.3 The company has receivables management policy that is used to select customers....................56

4.3.3.4 All customers pay back their amount due. 56

4.3.3.5 Credit control department collects and receives payments. 56

4.3.3.6 The company has accurate records for debtors who normally take goods on credit. 56

4.4 Correlation Analysis 57

4.5 Conclusion 59

**CHAPTER FIVE 60**

**SUMMARY CONSLUSION AND RECOMMENDATIONS 60**

5.0 Introduction 60

5.1 Summary of findings 60

5.1.1 Inventory management and profitability 60

5.1.2 Cash management and profitability 60

5.1.3 Accounts receivables and profitability 60

5.2 Conclusions 61

5.3 Recommendations 62

5.4 Areas of further research 62

REFERENCES 63

APPENDIX I 66

QUESTIONNAIRE 66

APPENDIX II: INTERVIEW GUIDE 70

APPENDIX III 71

RV. Krejcie and D. W. Morgan (1970) Sample Size Estimation Table 71

# LIST OF FIGURES

Figure 1: Conceptual Framework ........................................................................................ 9

# LIST OF TABLES

Table 4.1 Response rate ........................................................................................40

Table 4.2 showing the gender of respondents ..........................................................41

Table 4.3: Age group of respondents ......................................................................42

Table 4.4 Company department ..............................................................................42

Table 4.5: Showing duration of employment ..........................................................43

Table 4.6: showing the education level of the respondents. ...................................44

Table 4.7 Category of staff ......................................................................................45

Table 4.8: Showing mean and standard deviation of the role played by inventory towards profitability ..............................................................................................................46

Table 4.9: showing mean and standard deviation of cash management and profitability .......50

Table 4.10: showing mean and standard deviation of accounts payable and profitability ......54

Table 4.11: showing the relationship between working capital management and profitability ..................................................................................................................................58

## LIST OF ACRONYMS

MCL: Movit Company Limited

WCM: Working Capital Management

## ABSTRACT

The broad objective of the study was to establish a relationship between Working Capital Management and profitability of manufacturing companies case study of Movit Company Limited The specific objectives of the study were to find out the effect of inventory management and profitability, to find out the relationship between Accounts receivable and profitability, to find out the role of cash management in profitability of Movit Company Limited.

A case study design with both qualitative and quantitative approaches was used in the study which involved a sample of 80 respondents drawn from the study population of 100 workers. SPPS was used to analyze the quantitative data to develop tables and a figure. The time frame of the study was cross section.

The major findings of the research indicated that the company doesn't have enough space for storing raw materials, goods in process and finished goods yet inventory management is required for smooth marketing operations which in turn increases the profitability of the company. The company is good at recovering its debts and this leads to an increase on the profitability levels.

The business keeps financial records and manages its cash flow which helps the company to synchronize cash inflows with cash outflows by using cash budgeting and forecasting in formulating cash management strategy which in turn leads to an increase in the profitability if the company. The result also revealed that there is a positive correlation between Working Capital Management and Profitability with (r=.7872, and p=.01) meaning that there is a relationship between Working Capital Management and profitability.

Recommendations of the study included that Movit Company Limited should identify the most profitable items so as to achieve higher sales targets which in turn lead to an increase in the profitability, there should be an improvement on the inventory by carrying out physical counts so as to know the available stock and the reorder levels, the company should also emphasize a strong budget control so as to know how much is supposed to be spent in a given period of time hence improving on the cash management which in turn leads to an increase on the profitability.

# CHAPTER ONE

# GENERAL INTRODUCTION

## 1.0 Introduction

The effective and efficient management of working capital has a favorable impact on both short-run and long-run organizational goals and objectives and this comprise of profit maximization (Pandey, 2000). Sound financial and statistical techniques supported by judgment are used to predict the quantum of working capital needed at different time periods (Pandey, 2000) and hence the need for this study which focused on working capital management and profitability of manufacturing industry.

Pandey (1999) asserts that cash is the most important current asset for the operation of the business firm and it is therefore seen as the basic input needed to keep a business running on a day-to-day basis. Kurfi (2003) adds that cash then becomes the lifeblood of any business enterprise. To have cash as the life wire of every firm, working capital management as a tool to achieve optimal goal of business becomes paramount.

This chapter comprise of background of the study, problem statement, purpose of the study, specific objectives, research questions, scope of the study, justification of the study, significance of the study, conceptual frame work and definition of key terms.

## 1.1 Background of the study

WCM has gone through succession development stages since early introduction in early 20$^{th}$ century. In any stage managers tend to put a problem in order to find solutions while it is true to assume that scholars provide new horizons while managers implement findings to prove usefulness. The evolution of WCM has some debates between managers and academicians. Nevertheless, making sense of WCM research today and likely the future directions requires

an in-depth understanding of historical perspectives (Medwell journals, 2015).

Awareness era (1900-1940s) and in this period there was limited development in WCM research as discrete management practice largely due to limited research. A research of the ABI inform Database found only 23 studies related to working capital published in various journals in this period and these appeared to be an inconsistent interpretation of what was included within the term working capital. Disputes over definitions and categories of working capital indicate a learning stage, developing an understanding of working capital characteristics and seeking common ground between working capital theory and practice ( International Business Management Journal, 9(5): 987-997, 2015).

The concept of working capital became established in 1940s. Though there were some disagreements as to exact meaning of working capital (Paddy, 1998). The confusion at that time centered on how properly they classified current assets (as one of the main component of working capital, the other one being current liabilities) and that is whether current assets should be defined as those that will be converted on the short term being taken as one year.

One of the earliest definitions of working capital was proposed by Mann (1918). He defined working capital as the amount of money or money equivalent or required to finance a company's operations. It is also known as Net Working Capital (NWC), the amount of capital required keeping a company in operations or staying liquid. NWC is a reflection of the operating cycle financing alternatives and liabilities obligation.

In 1947, the committee on accounting procedures of American Institute of Accountants issued an Accounting Research Bulletin (ARB), No.30 which defined working capital and classified the operating cycle. It stated: Working Capital sometimes called net working capital is represented by the excess of current assets over current liabilities and identifies the relatively liquid portion of total enterprise capital which constitutes a margin or buffer for

meeting obligations to be incurred and liquidated within the ordinary operation cycle of the business (CAP/ATA, 1947).

The pre and post-world war II Era (1920-1950s) had significant influence on the development of working capital studies. The overlapping period between awareness stage and this era was due to similar operating environment and evidence (development of working capital) appeared in both periods. The main argument in this period is revolved around appropriate levels and financing of working capital. Benjamin (1939) stated that companies were better off having positive Net working capital as it would improve liquidity. Positive net working capital refers to companies keeping higher ratio of current assets to current liabilities and depending less on bank loans or supplier's credit to finance working requirements.

The industrialization era between 1950 and 1980s resulted in a change of direction in working capital studies. Advanced technologies and machinery transformed manufacturing sectors, enabling companies to gain benefits of economies of scale hence lowering operational cost (Kaplan, 1994). American companies grew in size and created multiple divisions to focus on many different business activities.

In Ethiopia, Working capital management is considered a particular importance to the profitability growth of a business entity. This is because without a proper management of working capital, it is difficult for the firm to run its operations smoothly. That is why Brigham and Houston (2003) conclude that about 60 percent of a typical financial manager's time is devoted to working capital management. Hence, the crucial part of managing working capital is maintaining the required liquidity in day-to-day operation to ensure firm's smooth running and to meet its obligations. On the other hand, Tiringo (2013) examined the impact of WCM on profitability of micro and small enterprises in Ethiopia for the case of Bahirdar city administration. The result showed that there is a strong positive relationship between number of day's accounts payable and enterprises profitability. However, number of days

accounts receivable, number of days inventory and cash conversion cycle have a significant negative impact on profitability.

The current squeeze on cash and credit is threatening the survival of many businesses all over the world generally and Nigeria in particular. Current Squeeze is considered the sources of company's working assets and liabilities (Asian Journal of Business and Management Science, volume 2, (01-08). The aftermath of this credit crunch is drastic reduction in production and sales, leading to massive retrenchment of workers and liquidation of many organizations. Unfortunately, not every company is able to find external financing easily. Where it is available, the cost of borrowing may be expensive, resulting in poorer bottom line. In view of this, liquidity management (working capital management) has become one of the most important issues in the organizations where many executives strive to identify the basic working capital drivers and the appropriate level of working capital.

According to Mathuva (2010) on a similar study done in Kenya, the relationship between the payable days, inventory days and profitability was found to be positive; this is conflicting with other researcher's findings. Mathuva (2010) in his research only used 30 samples which were listed in Nairobi Securities Exchange (NSE), further the market in Nairobi is not developed compared with the western market. These could be the possible reasons for the different conclusion by Mathuva (2010).The review of the previous studies gives us a clear link between the working capital management and profitability. Further it is evidenced that the total debt and size of the firm also affect the profitability of the firm.

Working capital is an important issue during financial decision making since it has been part of the investment in asset that requires appropriate finance in investment. Organization cannot over-rule the indispensability of an orderly organized system needed to account for their activities of the organization. Suitable systems for each organization are therefore designed in accordance

with the outlined or tasted goals and objectives. The working capital management decision is often used in the business language. Wanda Miki (2001) talks much about working capital management and its influence on organization and he defined it as the amount of short-term assets that the firm should keep at hand in order to operate the long term capacity efficiently and effectively.

Furthermore (Paddy 2001) explains the concept of working capital in two ways that is to say the gross working capital and networking capital. Gross working capital, refers to the firm's investment in current assets. Current assets are the assets which can be converted into cash within an accounting year (for operating cycle) while networking capital refers to the difference between current assets and current liabilities. Current liabilities are those claims of outsiders, which are expected to mature for payment within an accounting year and include creditors (account payables), bills payable and outstanding expenses. Networking capital can be positive or negative that is to say a positive working capital will arise when current assets exceed current liabilities while a negative working capital occurs when current liabilities are in excess of current assets.

## 1.2 Problem Statement

Financial performance of corporate organizations is a major source of concern to the financial manager, the entire management as well as the shareholders. This is more so as it is expected that every corporate organization of any kind should make a fair return to justify its existence. This obviously calls for proper management of working capital which according to many researchers like Deloof (2006), Smith (1980), Lamberson (1995), Eljelly(2004), Hall (2002), Soenem (1993), have a significant impact on firm's profitability. According to the Movit financial report 2011, the company registered numerous losses of opportunities due to insufficient working capital as reported by the managing Director (Lutaaya Meddy 2015). This was as a result of partially limited cash at hand, limited cash at bank and lack of

technical personnel and machinery as well. Hence, lack of proper research study on the area gives a chance to company's managers to have limited awareness in relation to working capital management to increase firms' profitability. All these constitute the problem of the investigation, hence the need to study the impact of working capital management on the performance of manufacturing industries in Uganda, case study of Movit Company Limited.

## 1.3 Study objectives

### 1.3.1 General Objectives

To examine the relationship between Working Capital Management and the profitability of manufacturing companies.

### 1.3.2 Specific objectives

To find out the effect of Inventory Management on profitability of manufacturing industries.

To find out the relationship between Accounts receivables and profitability of manufacturing industries.

To find out the role of Cash Management in profitability of manufacturing industries.

## 1.4 Research Questions

The research questions to be answered are:

i) What is the effect of Inventory Management on profitability of manufacturing companies?

ii) What is the role played by Accounts receivable on profitability of manufacturing companies?

iii) What is the relationship between Cash Management and profitability of manufacturing companies?

## 1.5 Scope of the study

### 1.5.1 Subject scope

The study focused on Working Capital Management as the independent variable and Profitability as the dependent variable. A deeper review on the dimensions of Working capital management which include Inventory Management, Accounts receivable and payable, and cash management will be made to establish their relationship with profitability. The dimensions of profitability considered are Gross profit margin, Net profit margin and Return on equity.

### 1.5.2 Geographical scope

This study is limited and covers the working capital management of Movit Company Limited in Nyanama-Rubaga Division, 13.2km from Kampala town.

### 1.5.3 Time scope

The study covered a period between 2013 and 2016 and literature ranging from 1989 to 2016. This time was selected because it is around this time working capital management had become a very big factor in influencing profitability of manufacturing companies and it was mostly emphasized by Uganda Manufacturers Association.

## 1.6 Significance of the study

The study's findings will help the manufacturing firms in Uganda and other companies in general improve on their financial decision making so as to optimize the value of the shareholders and maintain a favorable level of profitability.

The findings will also be of great benefit to future researchers in the field of working capital management in providing relevant literature in building up the course of study. It will also benefit other scholars and students of finance who may use the findings for academic

purposes.

The study will recommend ways through which working capital can be effectively utilized in financial decision making of manufacturing firms. This effective utilization in the long run increases the wealth of the shareholders.

The study findings will assist in policy formulation for the industrial sector for operational efficiency. It is also a key pillar to helps managers improve performance of the firm.

This work will also be useful to policy formulators such as company managers, as to the optimum working capital policy to adopt so as to bring about effective working capital management and enhance profitability.

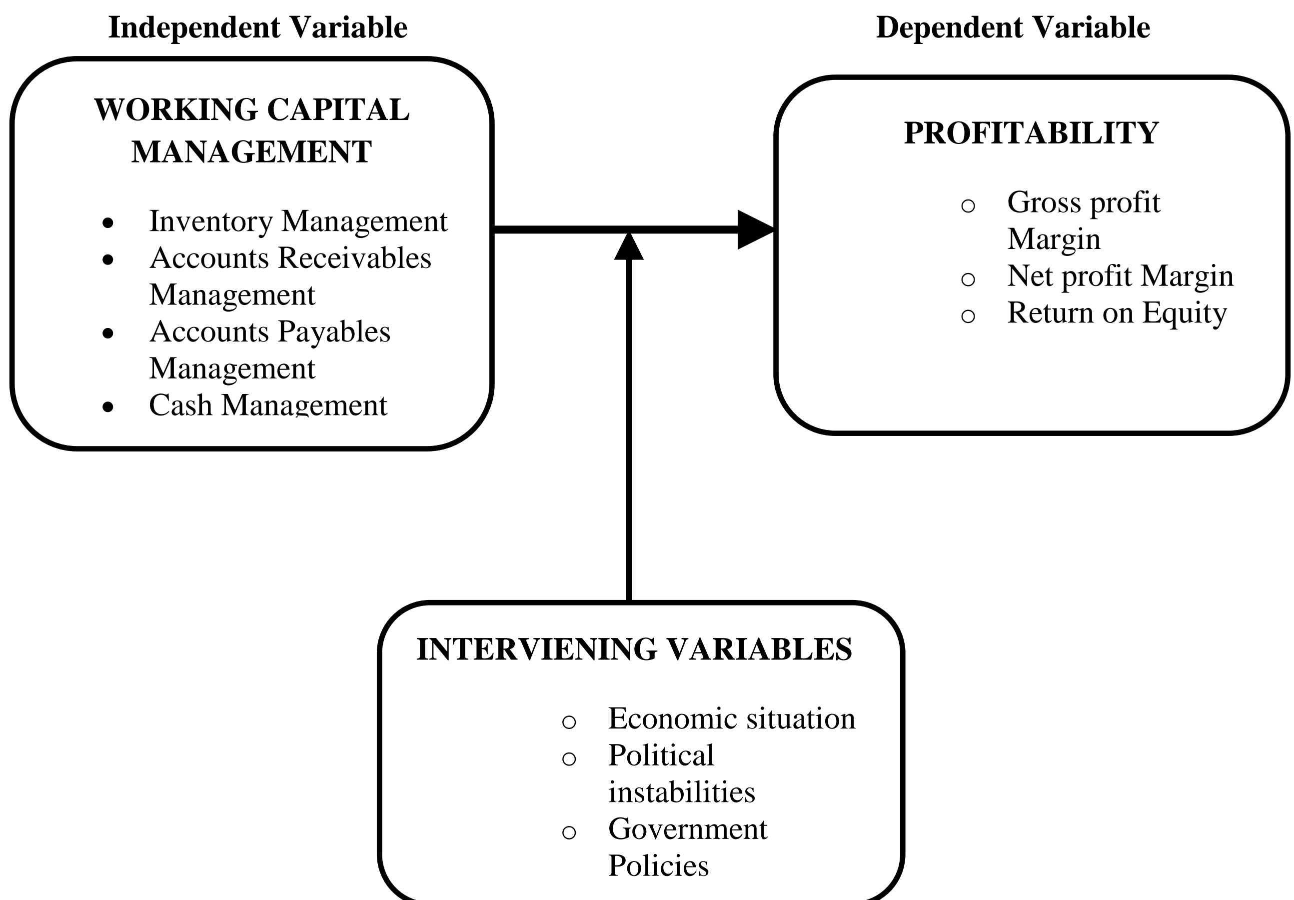
**1.7 Justification of the study**

Earlier focus in working capital management (WCM) has been on the close relationship between working capital and the company's liquidity and profitability as studied by Pass and Pike (1984), Shin &Soenen (1998) amongst others. Several studies have concentrated on different aspects of working capital management and how managers could create more value by managing effectively different components of the working capital. Kolay (1991) stresses the importance of a proactive working capital strategy as working capital is situation dependent and strategy needs to be assessed and adapted. Maynard E. Rafuse (1996:59) suggests that those companies who are aiming for minimizing their working capital strategies should concentrate on managing their stocks. The aim here is to study the short-term assessments of companies' working capital management and how well firms have responded their working capital needs to improve on their profitability.

### 1.8 Conceptual framework

The conceptual framework sets the terms of reference for the analysis. It defines the main concepts and notions, outlines how the basic elements are connected, and describes the intervening variables (Myntz, 2002). At the same time, it may be read as a guide to the rest of the study. The independent variable is working capital management and profitability is the dependent variable. The dimensions under working capital management include inventory management, Accounts receivable management, and Cash management. On the other hand, profitability comprised of gross profit margin, net profit margin and return on equity.

**Figure 1: Conceptual Framework**




***Source:*** Wanda Miki (2001) and modified by the researcher.

The figure above illustrates the relationship between working capital management and

profitability of manufacturing companies. Working Capital management explicitly impacts both the profitability and level of desired liquidity of a business (Wanda Miki, 2001). When a firm invests heavily in working capital that is to say, more than its needs, then the profits which can be generated by investing these resources in fixed or long term assets will be diminished. Moreover the firm will have to endure the cost of storing inventory for longer periods as well as the cost of handling excessive inventory (Arnold, 2008).

### 1.9 Definition of key terms

**Profitability:** This is ability of a company to use its resources to generate revenues in excess of its expenses. In other words, this is a company's capability of generating profits from its operations.

**Working Capital Management**: This refers to a company's managerial accounting strategy designed to monitor and utilize the two components of working capital, current assets and current liabilities, to ensure the most financially efficient operation of the company.

**Cash Management:** This is the corporate process of collecting and managing cash, as well as using it for (short-term) investing. It is a key component of ensuring a company's financial stability and solvency.

**Inventory Management:** This is the practice overseeing and controlling of the ordering, storage and use of components that a company uses in the production of the items it sells. It also the practice of overseeing and controlling of quantities of finished products for sale. A business's inventory is one of its major assets and represents an investment that is tied up until the item sells.

**Accounts Payables:** Accounts payables is the aggregate amount of an entity's short-term obligations to pay suppliers for products and services which the entity purchased on credit. Accounts payables are considered a source of cash, since they represent funds being

borrowed from suppliers.

**Accounts Receivables:** These are short-term amounts due from buyers to a seller who have purchased goods or services from the seller on credit. Accounts receivable is listed as a current asset on the seller's balance sheet.

**Return on Equity:** This measures the effectiveness of a company's management to turn a profit on the money that its shareholders have entrusted it with.

**Gross profit Margin:** This is a financial metric used to assess a company's financial health and business model by revealing the proportion of money left over from revenues after accounting for the cost of goods sold (COGS).

**Net Profit Margin:** This is the percentage of revenue remaining after all operating expenses, interest, taxes and preferred stock dividends (but not common stock dividends) have been deducted from a company's total revenue.

## 1.10 Conclusion

Conclusively, working capital management entails the management of the most liquid resources of a firm with a view to maintain the firm’s liquidity, enhance profitability and promote business growth. Working capital management concentrates on the management of inventories, cash and cash equivalents and accounts receivable. The proper management of these items is critical to the success of an organization.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.0 Introduction

This chapter presents a review of literature related to working capital management and how it relates to the manufacturing industry's profitability. The review is based on the objectives of the study.

## 2.1 Conceptual Review

### 2.1.1 Working Capital Management

Working Capital Management is concerned with all Management areas regarding finance not only sources and use of finance in the company, but also the financial implications of investment, production, marketing or personnel decision and the total performance of the company(Meredith, 1986). From another point of view, Working Capital Management is concerned with raising funds needed to finance the company's assets and activities, allocating these scarce funds between competing users and ensuring that those funds are used effectively and efficiently in achieving the company's targets (McMahon, Holmes, Hutchinson &Forsaith, 1993).

WCM involves planning and controlling current assets and current liabilities in a manner that eliminates the risk of inability to meet due short term obligations on the other hand and avoid excessive investment in the assets (Eljilly, 2004).

Working Capital Management is a very sensitive area in the field of financial management (Joshi, 1994). It involves timely decisions on the amounts and composition of current assets and the financing of these assets. Current assets include all those assets that in the normal course of business return to the form of cash within a short period of time, ordinarily within a

year and such temporary investment as may be readily converted into cash upon need. The success of a firm depends ultimately, on its ability to generate cash receipts in excess of disbursements.

According to Van Horne (1977), working capital management is the administration of current assets in the name of cash, marketable securities, receivables, and inventories. Osisioma (1997) described working capital management as the regulation, adjustment, and control of the balance of current assets and current liabilities of a firm such that maturing obligations are met, and the fixed assets are properly serviced.

Working capital, also referred to as net working capital (NWC), is an absolute measure of a company's current operative capital employed. It is the capital required in the short term to run a business. Working capital management involves short term asset accounts such as cash, inventory and accounts receivable as well as short term liability accounts such as accounts payable (Harford, 2009) Current assets are assets which are expected to be sold or otherwise used within one fiscal year. Current liabilities are considered as liabilities of the business that are to be settled in cash within the fiscal year. According to Harris (2005) Working capital management is a simple and straightforward concept of ensuring the ability of the firm to fund the difference between the short term assets and short term liabilities. Nevertheless it is a complete mean and average approach preferred to cover all its company's activities related to vendors, customer and product.

Working Capital Management refers to the financing of current assets from current liabilities particularly in the form of interest free credit from supplies is a less expensive source of financing than equity or long term debt capital (Van Vorne, 1995).

### 2.1.2 Profitability

Profitability is the primary goal of all businesses ventures. Without profitability, the business

will not survive in the long run. So measuring the current and past profitability and projecting future profitability is very important. Profitability is measured with income and expenses. This is also the basis of measure of success of any business. A business that is not profitable cannot survive. Conversely, a business that is highly profitable has the ability to reward its owners with a large return on their investment. Increasing profitability is one of the most important tasks of the business managers. Managers constantly look for ways to improve profitability (Malome, 2014).

According to Goudreau (1992) profitability measures commonly used include the rate of return on assets (ROA), the rate of return on equity (ROE), the rate of return on investment deposits (ROD), and the capital-assets ratio (capitalization).

A profit is what is left of the revenue a business generates after it pays all expenses directly related to the generation of the revenue, such as producing a product, and other expenses related to the conduct of the business' activities. (Hofstrand, 2013).

Company's profitability is an essential measure to management as it is an outcome which has been achieved by an individual or a group of individuals in an organization related to its authority and responsibility, not against the law, and conforming to the morale and ethic. Such profitability is the function of the ability of an organization to gain and manage the economic resources in several different ways to develop competitive advantage (Hansen & Mowen, 2005).

## 2.2 Theoretical review

Working capital management involves the relationship between a firms short term assets and its short term liabilities (Pandey, 2005).The goal of working capital management is to ensure that a firm is able to continue its operations and that it has sufficient ability to satisfy both maturing short term debt and upcoming operational expenses (Padachi, 2007). The

management of working capital involves the management of inventories, accounts receivable and payable and cash. Working capital refers to current assets and in particular Cash, Debtors and Stocks (Manasseh, 2001). The theories of Working Capital Management are presented below;

### 2.2.1 Agency Theory

The agency theory is used to investigate the information asymmetry between principals (shareholders) and agent (management). In this study, the agency theory is to determine the effect of working capital management systems on the profitability of manufacturing firms. Sarens and Abdolmohammadi (2011) state that according to the agency theory, a company consists of a set of linked contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling these resources. A significant body of work has been undertaken in this area within the context of the principal-agent framework.

The work of Jensen and Mecklin (1976) in particular as well as that of Fama (1980) is important. Agency theory identifies the agency relationship where one party, the principal, delegates work to another party, the agent. The agency relationship can have a number of disadvantages relating to the opportunism or self-interest of the agent: For example, the agent may not act in the best interests of the principal, or the agent may act only partially in the best interests of the principal. There can be a number of dimensions to this including for example, the agent misusing their power for pecuniary or other advantage, or the agent not taking appropriate risks in pursuance of the principal’s interests because the agent views those risks as not being appropriate while on the other hand the principal may have different attitudes to risks.

There is also the problem of information asymmetry whereby the principal and the agent have

access to different levels of information; in practice this means that the principal is at a disadvantage because the agent has more information. The theory was therefore very relevant in this study as shareholders who are the owners of the manufacturing firms have delegated the responsibilities of daily running of the companies to the management who acts as their agents and hence great need for strong working capital management systems to ensure shareholders and other stakeholder's interests are adequately safeguarded. The theory therefore supports existence of control environment, working capital management and risk management.

Agency theory is concerned with resolving problems that can exist in agency relationships; that is, between principals (such as shareholders) and agents of the principals (for example, company executives). The two problems that agency theory addresses are: the problems that arise when the desires or goals of the principal and agent are in conflict, and the principal is unable to verify what the agent is actually doing and the problems that arise when the principal and agent have different attitudes towards risk. Because of different risk tolerances, the principal and agent may each be inclined to take different actions.

Adams (1994) in his article stated that Agency theory can provide for richer and more meaningful research in the working capital management discipline. Agency theory contends that working capital management, in common with other intervention mechanisms like financial reporting and external audit, helps to maintain cost-efficient contracting between owners and managers. Agency theory may not only help to explain the existence of working capital management in organizations but can also help explain some of the characteristics of the working capital management department, for example, its size, and the scope of its activities, such as financial versus operational auditing. Agency theory can be employed to test empirically whether cross-sectional variations between working capital management practices reflect the different contracting relationships emanating from differences in

organizational form.

### 2.2.2 Operating Cycle Theory

The operating cycle theory looks explicitly at one side of working capital that of current assets and therefore gives income statement measures of firms operating activities that is about production, distribution and collection. Receivables, for instance are directly affected by the credit collection policy of the firm and the frequency of converting these receivables into cash matters in the working capital management. By granting the customers more liberal credit policy, the profitability will be increased but at the same time liquidity will be sacrificed. The same analysis goes for other components of current assets account. However the operating cycle theory tends to be deceptive in that it suggests that current liabilities are not important in the course of the firm's operations. Our understanding of payables as the source of financing the firm's activities can be assailed as a result. Given this inadequacy of the operating cycle theory, it is essential to infuse current liabilities in the picture to enhance our analysis and understanding. Although the operating cycle considers financial flows come from receivables and inventory, it ignores the financial flow coming from accounts payables in this regard. Richards and Laughlin (1980) suggested the cash conversion cycle which considers all relevant cash flows comes from the operations.

With Operating Cycle theory, the longer the period of the cycle, the bigger will be the Working capital requirement. Therefore companies should emphasize short cycle of raw materials to work in progress to finished goods to accounts payable and finally cash so as to have proper working capital management hence increasing on the profitability levels.

### 2.2.3 Cash Conversion Cycle Theory

It is the cash conversion cycle theory integrates both sides of working capital. In their seminal paper, Richards and Laughlin (1980) devised this method of working capital as part of a

broader framework of analysis known as the working capital cycle. It claims that the method is superior to other forms of working capital analysis that rely on ratio analysis or a decomposition of working capital as claimed above. The CCC is calculated by subtracting the payables deferral period (360/annual payables turnover) from the sum of the inventory conversion period (360/annual inventory turnover) and the receivables conversion period (360/annual receivables turnover). More recently, the number of days per year that appears in the denominator as 360 has been replaced by 365 to improve accuracy. Since, each of these three components is denominated by some number of days, the CCC is also expressed as a number of days. It has been interpreted as a time interval between the cash outlays that arise during the production of output and the cash inflows that result from the sale of the output and the collection of the accounts receivable.

The cash conversion cycle is one of the most important metrics that a business owner should calculate when conducting a cash flow analysis of a company. All other things held equal, it is better to have a shorter cash conversion cycle rather than a longer one. It is a measure of the company's working capital. The company gets to know the number of days that cash stays tied up in the business process of the company. The cash conversion cycle is a measure or Working capital management which in turn affects the profitability of the business.

### 2.3 Inventory Management and Profitability

Inventories are the product a company is manufacturing for sale and the components that make up the product (Pandey, 2005a)has classified the various forms in which inventories exist in a manufacturing company as: raw materials, work-in-progress and finished goods. Stocks of raw materials and work-in-progress facilitate production, while stock of finished goods is required for smooth marketing operations (Hadley, 2006).In the context of inventory management, Pandey (2005b) opined that a firm is faced with the problem of meeting two

conflicting needs. First, to maintain a large size of inventories of raw materials and work-in-progress for smooth production and of finished goods for uninterrupted sales operations. Secondly, to maintain a minimum investment in inventories to maximize profitability. The objective of inventory management should be to determine and maintain optimum level of inventory investment which should normally lie between the two danger points of excessive and inadequate inventories. Inventory, therefore, plays an important role to determine the activities in producing, marketing and purchasing. Since inventory determines the level of activities in a company, managing it strategically contributes to profitability (Filbeck, Krueger &Preece, 2007).

Inventory control implies the coordination of materials controlling, utilization and purchasing. It has also the purpose of getting the right inventory at the right place in the right time with right quantity because it is directly connected with the production. The objective of any organization is to get a good return out of every cedi invested in the company. According to Pandey (2005) management through their policies, coordination, decision and control mechanisms must maximize the return on investment (ROI).

There have been numerous attempts to explain financial performance of companies in the fields of strategic management, accounting, finance, marketing and management science. Naturally each of these areas concentrates on different explanatory variables and therefore this study limits the survey to papers that are perceived as immediately relevant. In the US, Sanghal (2005) studied the effect of excess inventory on long term stock price performance. The study estimated the long-run price effects of excess inventory using 900 excess inventory announcements made by publicly traded firms during 1990-2002. The findings from the study revealed that inventory management has a great impact on the profitability of the firm.

Roumiantsev and Netessine (2005) investigated the association between inventory

management policies and the financial performance of affirm. The purpose of the study was to assess the impact of inventory management practices on financial performance across the period 1992- 2002.They used conventional firm specific variables (inventory levels, margins, and lead times) as explanatory variables. They found no evidence that smaller relative levels are associated with financial performance as measured by return on assets.

Little attempt was made to capture the perceptions of managers about the impact of inventory management practices on firm financial performance. Agus and Noor (2006) did measure the perception of managers about the impact of inventory management practices on financial performance of manufacturing firms in Malaysia. Eneje, Nweze and Udeh (2012) did measure effect of efficient inventory management on profitability of breweries in Nigeria.

In Greece, Koumanakos (2008) studied the effect of inventory management on firm performance in manufacturing firms operating in three industrial sectors in Greece, food textiles and chemicals were used in the study covering 2000 –2002 period. The hypothesis that lean inventory management leads to an improvement in a firm’s financial performance was tested. The findings suggest that the higher the level of inventories preserved (departing from lean operations) by a firm, the lower the rate of return. In conclusion, most of the studies reviewed concentrated on conventional firm level variables such as inventory levels, demand and lead time. Oko, Mgbonyebi and Umeadi (2008) carried out a research on the association of inventory control in enhancing business growth in Nigeria a survey of five selected manufacturing. Companies in Port Harcourt metropolis. They made use of simple percentage and chi-square. The analysis revealed significant relationship between inventory control and business growth.

### 2.4 Cash Management and Profitability

The purpose of cash management is to determine the optimal level of cash needed for the nature of business operation cycle (Hadley, 2006).The challenge of cash management is to balance the appropriate level of cash and marketable securities that will reduce the risk of insufficient funds for operations and opportunity cost of holding excessively high level of these resources (Filbeck, Krueger &Preece, 2007). Thus, a company's competency to synchronize cash inflows with cash outflows, by using cash budgeting and forecasting in formulating a cash management strategy is important.

Cash management is seen as one of the key aspects of efficient working capital management. Cash management involves planning and controlling cash flows into and out of the business, cash flows within the business, and cash balances held by a business at a point in time (Pandey, 2004). According to Wetson and Copeland (2008), cash management is concerned with optimizing the amount of cash available, maximizing the interest earned by spare funds not required immediately and reducing losses caused by delays in the transmission of funds. Holding cash to meet short term needs incurs an opportunity cost equal to the return which could have been earned if the cash had been invested or put to productive use. However, reducing this opportunity cost by operating with small cash balances will increase the risk of being unable to meet debts as they fall due, so an optimum cash balance should be found.

Managing cash is becoming ever more sophisticated in the global and electronic age of the 1990s as financial managers try to squeeze the last dollar of profit out of their cash management strategies (Block and Hirt 1992). Abel (2008) argues that cash is crucial in every business in terms of enhancing its survival and prosperity. Marfo-Yiadom (2002) also noted that cash is the hub and most coveted of all the assets of any business. Good cash management can have a major impact on overall working capital management. It is

objectively used to manage and determine the optimal level of cash required for the business operation and invested in marketable securities, which is suitable for the nature of the business operation cycle (Gitman, 2005).

According to Mclaney (2000), cash is much more than just one element of working capital. As the medium of exchange and store of value, cash provides the linkage between all financial aspects of the firm. More specifically it links short-and long-term financing decisions with one another, with decisions involving investment both in fixed assets and working capital. The term cash refers to the most liquid of assets, including demand deposits, money market accounts and currency holdings.

Moyer, et al, (1992) observed that cash and marketable securities are the most liquid of the company's assets. Cash is the sum of currency a company has on hand and the funds on deposit in bank checking accounts. Cash is the medium of exchange that permits management to carry on the various functions of the business organization.

According to Keynes (1973), positions on the motive for holding cash are merely transaction, precautionary and speculative motives. Companies hold cash in order to bridge the interval between the time of incurring business cost and that of the receipt of the sale-proceeds. In other words, companies hold a certain amount of cash in order to meet the regular expenses of their activity. Therefore, the higher the firm's ability to schedule its cash flows (depending on their predictability), the weaker the transactions-motive for holding cash would be. The transaction motive illustrates the cash holding of firms and therefore more applicable to SMEs. Weston and Copeland (2008) stated that companies need a cash reserve in order to balance short term cash inflows and outflows since these are not perfectly matched. This they referred to as the transactions motive for holding cash, where the approximate size of the cash can be estimated by forecasting cash inflows and outflows and by preparing cash budgets. In

addition to the cash reserve held for day to day operational needs, cash may be built up to meet significant anticipated cash outflows, for example arising from an investment project or the redemption of debt.

Van Horne (2000) claimed that companies do not hold cash for this kind of speculative purpose and can be assumed that this estimation is valid especially for SMEs which usually do not have the resources to make such complex financial decisions. The key elements of cash management are cash forecasting, balances management, administration of cash receipts and disbursements, and internal control (i.e. bank reconciliation) (Gitman, 2009). All the above is consolidated into what is referred to in finance language as the cash budget. Cooley and Pullen (1979) have identified three basic components of cash management thus, cash forecasting practices, cash surplus investment practices and cash control practices.

### 2.5 Accounts Receivables Management and profitability

Rafuse (1996) views accounts receivable (AR) as customers who have not yet made payment for goods or services, which the firm has provided. The objective of debtors (receivables) management is to minimize the time-lapse between completion of sales and receipt of payments (Hadley, 2006). Profits may be called real profits after the receivables are turned into cash (Srivastarva, 2004). Rafuse (1996) posited that the management of accounts receivable is largely influence by the credit policy and collection procedure.

Effective accounts receivable management is important and strategic, it affects the financial performance of a firm and a firm’s value. A firm’s competency to synchronize cash inflows with cash outflows in formulating a cash flow management strategy is important to a firm’s financial performance. The goal of accounts receivable management is to maximize shareholder wealth. Receivables are large investments in firm assets which are like capital budgeting projects measured in terms of their net present value (Emery et al 2004).

Receivables stimulate sales because it allows customers to assess product quality before paying but on the other hand, debtors involve funds which an opportunity costs. Based on the characteristic of accounts receivable; the element of risk, economic value and futurity explains the basis and need for efficient management of receivables.

Berry and Jarvis (2006) assert that a firm setting up a policy for determining the optimal amount of accounts receivable have to take into account the trade-off between the securing of sales and profits and the amount of opportunity cost and administrative costs of the increasing accounts receivable; the level of risk the firm is prepared to take when extending credit to the customer because the customer could default when payment is due and the investment in debt collection management.

Gill (2011) assert that the main objective of accounts receivable is to reach an optimal balance between cash flow management components. Cash flow management is the process of planning and controlling cash flow both into and out of a business, that is, cash flows within the business and cash balances held by a business at a point in time (Samilogu, 2008). Efficient accounts receivable management affords a firm improve on its profitability by reducing the transaction costs of raising funds in case of liquidity crisis (Ahmet, 2012).

Accounts receivable as a component of cash flow has a direct effect on the profitability of a business. Cash flow management refers to the management of movement of funds into and out of a business and involves the management of accounts payable, accounts receivables, inventory as well as the cash flow planning (Joshi2007). Efficient firms maintain an optimal level of cash flow that maximizes their value. Large inventories and generous credit policy may lead to high sales as well as reduce the risk of stock-out while at the same time stimulating sales (Lazaridis, 2005). Delaying payment of accounts payable to suppliers allow firms to access products or services and can be an inexpensive and flexible source of

financing, but on the other hand, (Kaur, 2010) state that it can be expensive if a firm is offering discount for early payment while on the same token, uncollected accounts receivable can lead to cash inflow crisis.

Accounts receivable management is a dynamic financial management process and its effectiveness is directly correlated with a firm's ability to realize its mission, goals and objectives (Sherman, 2010). Despite the role cash flow management plays, many firms have not implemented effective cash flow management practices and the results can be dire, Ahmet (2012). Even profitable firms can go bankrupt if they fail to manage their accounts receivable effectively, particularly, if they operate in rapid-growth or seasonal industries (Prere, 2010). For a credit policy to be effective it should not be static but requires review periodically to incorporate changes in a firms strategic direction and risk tolerance as well as to ensure that the firm operate in line with competition to ensure sales and credit departments are benefiting (Eliots 2009). Szabo (2012) note that due to the speed in which technology is changing and the dynamics in business caused by changes in the internal and external environment, the ways in which businesses are conducted today differ significantly from yester years. The competitive nature of the business environment require firms to adjust their policies and strategies frequently for survival and growth (Kathleen, 2010). Although a credit policy ensures decision making process is logical and simplified it is based on pre-determined parameters at a historical period in time which may not hold at the current time (Venancio 2013). Filbeck and Krueger, (2005) argue that a credit policy being the most important medium of managing and regulating accounts receivables requires frequent reviewing to ensure a firm maintains optimal investment in accounts receivable while minimizing costs associated with credit and at the same time maximizing the benefits from accounts receivable.

Extending credit to customers is a decision based on the credit management and policy of a firm.

Granting credit exists to facilitate sales. On the other hand, Al-Mwala (2012) state that sales are pointless without due payment and therefore the sales and accounts receivable functions must work together to achieve the objective of sales maximization within minimum length of time. Owalabi and Obida (2012) note that credit sales are a sign that firm is able to maximize its sales and improve its financial performance. According to Sushma (2007), an increase in the level of accounts receivables in a firm increases both the net working capital and the cost of holding and managing accounts receivable and both lead to a decrease in the value of the firm. Firms who pursue an increase in the accounts receivable to an optimal level increase their profitability resulting from the increased sales and market share.

Extending credit to customers is a decision based on the credit management and policy of a firm.

Granting credit exists to facilitate sales. On the other hand, Al-Mwala (2012) state that sales are pointless without due payment and therefore the sales and accounts receivable functions must work together to achieve the objective of sales maximization within minimum length of time. Owalabi and Obida (2012) note that credit sales are a sign that firm is able to maximize its sales and improve its financial performance. According to Sushma (2007), an increase in the level of accounts receivables in a firm increases both the net working capital and the cost of holding and managing accounts receivable and both lead to a decrease in the value of the firm. Firms who pursue an increase in the accounts receivable to an optimal level increase their profitability resulting from the increased sales and market share.

### 2.6 Working capital Management and profitability

According to Adeniji (2008), there are no specific set of rules or formulae to determine the working capital requirements of firms. A large number of factors, each having a different importance influences working capital needs of firms. The factors which generally influence

the working capital requirements of firms include nature of business, sales and demand conditions, technology and manufacturing policy, credit policy of a firm, operating efficiency, price level changes and credit granted by suppliers.

The level of investment in current assets has a bearing on the profitability of the firm. Excess of investment in working capital casts a negative impact on the profitability of a firm and positive impact on the liquidity. Firms with too few current assets may incur shortages and difficulties in maintaining smooth operations (Horne and Wachowicz, 2000). Efficient working capital management involves planning and controlling current assets and current liabilities in a manner that eliminates the risk of inability to meet short term obligations due on one hand and avoiding excessive investment in these assets on the other hand (Eljelly, 2004).

Smith (1980) suggests that working capital management is important because of its effects on a firm's profitability and risk, and consequently its value. Specifically, a more aggressive working capital policy (low investment in working capital) is associated with a higher return and risk, while a conservative working capital policy (high investment in working capital) supposes a lower return and risk. These effects on profitability and risk, therefore, suggest that firms might have an optimal working capital level that balances the costs and benefits of holding working capital and maximizes their profitability.

According to Kargar and Bluementhal (1994) bankruptcy may also be likely for firms that put inaccurate working capital management procedures into practice, even though their profitability is constantly positive. Hence, it must be avoided to recede from optimal working capital level by bringing the aim of profit maximization in the foreground, or just in direct contradiction, to focus only on liquidity and consequently pass over profitability. While excessive levels of working capital can easily result in a substandard return on assets;

inconsiderable amount of it may incur shortages and difficulties in maintaining day-to- day operations.

Most of the empirical studies support the traditional belief about working capital and profitability that reducing working capital investment would positively affect the profitability of firm (aggressive policy) by reducing proportion of current assets in total assets. Deloof (2003) analyzed a sample of Belgian firms, and Wang (2002) analyzed a sample of Japanese and Taiwanese firms, emphasized that the way the working capital is managed has a significant impact on the profitability of firms and increase in profitability by reducing number of day's accounts receivable and reducing inventories. Soenen (1998) analyzed a sample of US firms and reported similar findings but having used Net Trading Cycle (NTC) as comprehensive measure of working capital management and found significant negative relationship between NTC and profitability.

Efficient utilization of the firm's resources and better management of receivables means that firms' management should find effective and efficient ways to deal with the cash available for the day-to-day operations in order to achieve the optimum impact. Good working capital management leads to increased cash flows, and thus leads to lesser need on external financing therefore; the probability of default for the firm is reduced (Deloof, 2003).

## 2.7 Intervening variables

Below are the other factors which affect the profitability of the company other than Working capital management;

### 2.7.1 Economic factors

Leverage is viewed as a result of events that determines companies' source of financing to run the business. Modigliani and Miller (1958) were the pioneers of the theory assumed that a business's value is distinct from its debt and equity mix of financing but ignoring issues that

play a positive role in determining the best capital structure such as corporate taxes. Consequently, Modigliani and Miller (1963) reaffirmed that corporate taxes are significant characteristic in of capital structure. Copeland and Weston (1983) stated that this depends on the contention that the weighted average cost of capital stays constant as leverage changes. Companies that possess high level of leverage in their capital structure are able to decrease their free cash flow. Companies through utilizing the additional leverage; the free cash flow as an alternative of being inadequately employed by the management given instantly to the debtors and is withdrawn from the company as interest expenses. Company's capital structure that includes a large amount of debt/equity tends to increases the risk of bankruptcy; that is when company's total debts equal to total assets (Khan, A.et al., 2012). Free cash flow denotes the cash that a company is capable of generating after putting aside the cash required to preserve their assets. Free cash flow also permits a company to track investment prospects as they arise to improve shareholder wealth. Capital structure decisions rely on two major sets of theories namely, the trade-off theory and the pecking order theory.

According to previous studies, financial leverage affects cost of capital, ultimately influencing firms' profitability and stock prices (Higgins, 1977; Miller, 1977; Myers, 1984; 1Sheel, 1994). Also, several researchers have studied firms' debt use and suggested the determinants of financial leverage by reporting that firm's debt-equity decision is generally based on a trade-off between interest tax shields and the costs of financial stress (Kim, 1997; Sheel, 1994; Sunder & Myers, 1999; Titman &Wessles, 1988; Upneja&Dalbor.

### 2.7.2 Firm Size

Gibrat (1931) devised a model of the dynamics of individual firms that predicts that all firms grow at the same proportional rate, irrespective of their initial size (Gibrat's law) implying that large, medium and small firms have the same average proportionate rates of

growth. Mansfield (1962), however, argued that the departure from the Law decreases as firm size increases due to the exit of slow-growing small firms from the industry. The learning model by Jovanovich (1982) shows that young firms grow faster than old ones as a result of accumulation of market knowledge overtime. Since young firms are usually smaller than older businesses, Jovanovich concludes that small firms grow faster than large ones.

A comparable study was made by Prasetyantoko and Parmono (2008) who re-evaluated earlier findings against new data within an improved analytical framework. The study by Prasetyantoko and Parmono included the entire distribution of firms. Results showed that firm size influences profitability in some, but not all industries. Since profitability is ultimately determined by several complex factors including product prices, factor costs, and the production function, the relationship to size varies among industries and cannot be readily identified. Thus, the hypothesis that size does matter cannot be offered without providing relevant qualifications.

Another study by Agiomirgiannakis et al (2006) suggested that size is positively related to a firm's ability to produce technologically complicated products which in turn leads to concentration. Such markets are supplied by few competitors and are therefore, more profitable. Thus, larger firms have access to the most profitable market segments. The empirical relationship between a firm's size, structure, and profitability has found that size is positively correlated with profitability (Gichura, 2011), with the profit rate of the market positively correlated with the concentration ratio and negatively correlated with the marginal concentration ratio (Adams and Buckle, 2000). Amato and Amato (2004) show that the positive association between firm size and profitability stems from implementing greater differentiation and specialization strategies, and should therefore lead to higher efficiency. Further studies also suggest that larger firms are able to leverage on economies of scale (e.g. Bashir, 2003; Geroski et al, 2003; Chen & Wong,

2004).

Whittington (1980) even found a negative association between firm size and profitability for U.K. based listed manufacturing companies covering the time period from 1960 to 1974. While no suitable reasoning can be used to explain such a link, organizational theory may perhaps solve part of this quandary. Jermanis (2006) suggests that larger firms can lead to increased coordination requirements, which in turn, makes the managerial task more difficult leading to organizational inefficiencies and lower profit rates. Further, it has been suggested that increased size tends to be associated with higher bureaucratization (Liargovas& Skandalis, 2008). Larger firms may have overly bureaucratic management structures, thereby inhibiting swift and efficient decision-making process. It is also possible that with the additional management layers needed to organize an increasingly large and diverse workforce, management may be affected by the agency problems.

### 2.7.3 Sales growth

Delmar et al (2003) discussed the various performance measures and suggested that if only one indicator had to be chosen as a measure of firm growth, then the preferred measure of growth should be sales. Sales figures are relatively easy to obtain and reflect both short term and long-term changes in the firm. In addition, as Barkham (1996) points out, it is also the indicator favoured by entrepreneurs themselves. Other arguments for using sales growth are based on the growth process being driven by demand for the firm's products and services. Increasing sales will allow growth along other dimensions such as employees and assets. Sales though, may not always the best measure of performance. Delmar et al (2003) note that start-up and high technology firms may grow significantly in employment and assets before any significant sales are made. As a

result, growth in employment and assets should also be considered as performance measures.

The relationship between performance measures such as sales growth and profitability over time is therefore an important area of investigation. Marris (1967) considered the relationship between these measures and suggests that there is an identifiable growth profit trade-off, where in order to finance growth, the firm must forego profits. Cowling (2004) investigated this relationship between growth and profitability and found little evidence of the growth versus profit trade-off. He suggested that there is potential for a cumulative type effect whereby profits engender growth and growth engenders future profit that allows some firms to continually face increasing returns to scale.

## 2.8 Conclusion

Companies typically depend on working capital management for their profitability. Most of the companies as a sequence of financing, invest large quantities of their cash in considerable amounts of short-term payables and receivables in addition to in working capital. To maximize the cost of the firms they need to have working capital managed at an optimum level. Profitability and efficiency both are meaningfully impacted by the management of working capital. To construct worth for the shareholders it is very essential to manage working capital proficiently (Shin &Soenen, 1998). To get profitability and attain liquidity at maximum it is compulsory to track the silent goals of working capital management. Also those who encouraged working capital theory they pooled profitability. However, the issue remains open to further research.

# CHAPTER THREE

# METHODOLOGY

## 3.0 Introduction

This chapter presents the methodology that was applied to determine the effect of Working Capital Management on profitability of manufacturing companies. This chapter consists of introduction, the research design, study population, sample size and sampling technique, data collection method, data collection instruments, validity and reliability, procedures for data collection, data analysis, ethical issues.

## 3.1 Research Design

A research design according to (Kumar, 2005) is a plan, structure and strategy of investigation so conceived as to obtain answers to research questions or problems. Chandran (2004) describes research design as an understanding of conditions for collection and analysis of data in a way that combines their relationships with the research to the economy of procedures. Kombo (2006) suggest that research design deals with the detailing of procedures that are adopted to carry out a study. A research design has two functions according to (Kumar, 2005). Through the research design, one can conceptualize the research design and ensure that the procedures are adequate to obtain valid, objective and accurate answers to the research questions. Patton (2002) recommends that a combination of both qualitative and quantitative method be employed to enrich the research.

The research was a case study design. Mugenda and Mugenda, (1999) stated that a casual study is an in depth investigation of an individual group, institution or phenomenon whose purpose is to determine the relationship that has been caused by phenomenon of the study. The research seeks to assess the relationship between working capital Management and profitability of manufacturing companies.

### 3.2 Area of the Study

The study was carried out in Movit Company Limited-Bunamwaya Wakiso district. This helped the researcher to critically investigate and concisely illustrate the impact of Working Capital Management on profitability of the company. This further helped the researcher to capture the respondents' attitudes, opinions and beliefs as they are essential elements for research. (Gay1996)

### 3.3 Study Population

Accordingly Ngechu (2004) a study population is a well-defined or specified set of people, group of things, households, firms, services ,elements or events which are being investigated. Thus, the population should fit a certain specification, which the researcher is studying and the population should be homogenous.

The study population comprised of top level managers from general manager, human resource department, finance department, production department, marketing department and other employees in the company with a study population of 100 respondents according to the human resource manager.

### 3.4 Sample Size

At times dealing with all the numbers even of the smaller accessible population would involve a tremendous amount of time and resources. It's therefore advisable for the researcher to further select a given number of members from the accessible population (Kothari 2004). The sample size was 80 and this was generated from the table by R.V Krejcie and D.W Morgan (1970).

### 3.5 Sampling techniques

The researcher used two sampling techniques as they are revealed below;

#### 3.5.1 Simple random sampling techniques

A simple random sampling technique was used to select workers who were used in the process of data collection. The advantage of this method is that there is no bias and every employee has some chance of being selected into the sample. Also according to (Natalie, 2012) this technique of sampling simplifies data interpretation and analysis.

#### 3.5.2 Purposive sampling technique

Purposive sampling technique was used to select the sample because it allowed the researcher to acquire required information with respect to the objectives of the study. The subjects were handpicked because they possess the required information. Therefore respondents who possessed the required information were picked hence making the technique inexpensive and quick.

### 3.5 Data collection method

The following methods were used to collect data;

#### 3.5.1 Questionnaire

This method was the main method used in collection of data because it makes use of questionnaires which are distributed to respondents. The questions were both closed and open ended so as to invite concise and free responses. This is because they are relatively easy to analyze, simple to administer, relatively costly and the information is collected in a standardized way. Besides that, large amount of information was collected from a large number of people in a short period of time.

### 3.5.2 Interviews

This method of data collection involves presentation of oral verbal stimuli and oral verbal responses. In this method there is good response rate, it's complete and possible immediate questions and the interviewer was in control and in position to offer help in case of any problem. These interviews include face to face interviews and telephone interviews for interviewing very busy people. The questions were semi-structured so as to explore the issues.

### 3.5.3 Document review and analysis

This method of data collection comprises of secondary data on the relationship between Working Capital Management and profitability of manufacturing companies. Secondary data from various sources was analyzed and this complemented the data from interviews and questionnaires to produce a research report which is comprehensive. All the documents were thoroughly reviewed and collated to produce research report.

## 3.6 Research instruments

Questionnaires were distributed to respondents and the format which used was easily understandable by the respondents. Questionnaires were in English. The secondary data material sources included Newspapers, Reports, internet, and magazines.

Interview guides were used because it saves time for the researcher and the respondents since the researcher was asking questions and filling in information at the same time when interviewing the respondent.

A checklist is a type of informational job aid used to reduce failure by compensating for potential limits of human memory and attention. It helps to ensure consistency and completeness in carrying out a task. Just like the "to do list." and more advanced checklist

which are like schedule, which lay out tasks to be done according to time of day or other factors. Checklists were presented as lists with small checkboxes down the left hand side of the page. A small tick or checkmark was drawn in the box after the item has been completed.

## 3.7 Validity and reliability

### 3.7.1 Validity

McMillan & Schumacher (2006) stated that validity refers to the degree of congruence between the explanations of the phenomena and the realities of the world. Validity is the extent to which the instrument gives the correct answer. The questionnaire was tested for validity of all the possible dimensions of the research topic. The researcher prepared questionnaires which were approved by the university representative who is the supervising lecturer. The questionnaire was in a common local language and international language that is English which can be understood by many for the respondents to give valid answers. The interview guides which were used in the interviews were critically examined by the lecturer.

### 3.7.2 Reliability

Reliability was also established using SPSS Reliability Analysis. This was because of its easy and automatic applicability and fitted a two or more point rating scale. The instruments of the research were based on the Likert type five-point scale. Test and re-test method were used to provide reliable data. The researcher visited the same area of the study and conducted the same study after a period of one week to ensure that the data collected is consistent with the data that was generated in the first study.

## 3.8 Measurement of the variables.

Variables were measured using the 5 point Likert scale from a minimum of 1 for strongly disagree to a maximum of 5 for strongly agree. Likert scale was used to get participants

degree of agreement with statements. As Amin (2005), points out, Likert scale gives among others the following advantages, It gives participants a wide range of choices which makes them feel more comfortable in responding to questions. It is relatively a quick method of collecting information. Responses are gathered in a standardized way and questionnaires are easy to construct and responses can be collected from a large sample.

**Table 3.1: Interpretation of means using the 5-Likert scale**

| Description | Range | Mean | Interpretation |
| --- | --- | --- | --- |
| Strongly disagree | 1 | 1.00 -1.80 | Very low |
| Disagree | 2 | 1.81- 2.60 | Low |
| Neutral | 3 | 2.61-3.40 | Moderate |
| Agree | 4 | 3.41-4.20 | High |
| Strongly agree | 5 | 4.21-5.00 | Very high |

### 3.9 Data processing and analysis

The data collected was first edited with the view of checking completeness and accuracy. Data was coded and there after simple descriptive statistics, frequencies and percentages were computed to help in the discussion of findings. Pearson's correlation coefficient was used to determine the relationship between the variable. Discussions were done in accordance with the study objectives after which conclusions and recommendations were made on each objective as well.

### 3.10 Ethical issues

Throughout the research process, the researcher put into consideration the ethics of observing the right to privacy, confidentiality and anonymity of research subjects and informed consent from all subjects were used in the study to ensure that the researcher only engages respondents who are willing to take part in the study.

### 3.11 Limitation of the study

A number of limitations were encountered and these included the following:

Some of the respondents were not willing to give information and this problem was solved by assuring them that this study is purely for academic purposes.

Funds were limited; however this was solved by seeking financial assistance from relatives and friends.

Transport around the study area was a problem since it involved moving to different areas. The researcher solved this by using cheaper means like motorcycles and where it was near walk on foot.

# CHAPTER FOUR

# PRESENTATION, ANALYSIS AND DISCUSSION OF THE FINDINGS

## 4.0 Introduction

This chapter presents, analyses and interprets the data obtained from Movit Company Limited which was used as a case study in the assessment of working capital management and profitability of manufacturing companies. The analysis and the interpretation were based on the research objectives. Data will be presented in tables and figures with percentages and frequencies.

## 4.1 Response Rate

The researcher disseminated 80 questionnaires as was intended in chapter three, out of the 80 questionnaires, the researcher managed to get back 55 questionnaires and the remaining 25 were misplaced by the respondents while the remaining 5, were deliberately refused to be returned by the intended respondents. This implies that the response rate was 68.75%, meaning that 31.25% of the questionnaires were not returned. This is summarized in the table below

**Table 4.1 Response rate**

| Subgroup | Actual number of questionnaires | Not returned | returned | Response rate |
|---|---|---|---|---|
| Employees and employers | 80 | 7 | 73 | 91.25% |

***Source: Primary data (2017)***

Findings presented in the table 4.1. above revealed that 91.25% of the respondents participated in the study as 73 respondents managed to fully fill their questionnaires and

return them in time and only 7 respondents (8.75%) failed to return their questionnaires.

### 4.2 Background information of respondents

#### 4.2.1 Gender of respondents

The research was also concerned with the gender of the respondents. Studying the age composition of the workers at Movit Company Limited deemed necessary because different age groups react differently. The results are as shown in the table below;

**Table 4.2 showing the gender of respondents**

| Gender | Frequency | Percentage % |
|---|---|---|
| Male | 47 | 64.4 |
| Female | 26 | 35.6 |
| **Total** | **73** | **100.0** |

***Source: Primary Data 2017***

Findings presented in the table 4.2 above revealed that 64.4% of the respondents were male and 35.6% were females. This implies that the study researcher considered responses from both genders.

#### 4.2.2: Age of respondents

The researcher sought from the respondents their age distribution by grouping the respondents' age into different groups. The table 4.3 below shows the respondents' age group who were involved in the study.

**Table 4.3: Age group of respondents**

| Age group | Frequency | Valid Percentage |
|---|---|---|
| Below 25 | 18 | 24.7% |
| 25-29 | 25 | 34.2% |
| 30-34 | 15 | 20.5% |
| 35 and above | 15 | 20.5% |
| **Total** | **73** | **100.0%** |

***Source: Primary data (2017)***

Findings presented in the table 4.3. revealed that 24.7% of the respondents were below 25 years of age, 34.2% were aged 25 – 29%, 20.5% were 30 – 34yrs, 20.5% were 35years and above. This implies that all respondents who participated in the study were mature individuals in position of providing reliable information to the study questions administered.

### 4.2.3 Company department

The researcher investigated the different departments where the employees work. This was aimed at determining whether company departments can influence profitability of the company. The results are presented in table 4.4 below;

**Table 4.4 Company department**

| Department | Frequency | Percentage |
|---|---|---|
| Finance | 16 | 21.9% |
| Production | 20 | 27.4% |
| Sales and Marketing | 29 | 39.7% |
| Stores | 8 | 11.0% |
| **Total** | **73** | **100.0%** |

***Source: Primary data (2017)***

According to the results in the table above, 21.9% of the respondents were from the finance department, 27.4% were from the production department, 39.7% were from the sales and marketing department and 11% were from the stores department. This implies that the study researcher considered respondents from all departments with the intention of providing genuine arguments regarding organisational practices in respect to working capital management and profitability.

#### 4.2.4 Duration of employment

The respondents were also asked to identify their duration of employment with Movit Company Limited and the findings are revealed in the table below;

**Table 4.5: Showing duration of employment**

| Period | Frequency | Percentage |
|---|---|---|
| Less than 5years | 23 | 31.5% |
| 5-10 years | 25 | 34.2% |
| 10-15 years | 16 | 21.9% |
| 15years and above | 9 | 12.3% |
| **Total** | **73** | **100.0%** |

***Source: Primary data (2017)***

Findings presented in the table 4.5 above revealed that 31.5% of the respondents had stayed for less than 5years with the company, 34.2% had stayed for 5 – 10years, 21.9% had stayed for 10 – 15years and 12.3% had stayed for above 15years with the company. This implies that all respondents had stayed for a recognizable period of time with the company which affirms their capability in providing reliable information upon working capital management practices and profitability which are the major variables of the study.

### 4.2.5 Level of Education

Respondents were also asked to identify their educational levels and below are the responses:

**Table 4.6: showing the education level of the respondents.**

| Level of Education | Frequency | Percentage |
|---|---|---|
| Primary | 2 | 2.7% |
| Secondary | 9 | 12.3% |
| Certificate | 16 | 21.9% |
| Diploma | 21 | 28.8% |
| Degree and above | 25 | 34.2% |
| **Total** | **73** | **100.0%** |

***Sources: Primary Data (2017)***

From the findings in the table 4.6 above, 2.7% of the respondents had attained primary education, 12.3% had attained secondary education, 21.9% had certificates, 28.8% had diplomas and 34.2% were degree holders. All respondents had attained a recognizable level of education which implies that they were capable of providing reliable information to the questionnaires administered to them with certain phrased statements regarding the study variables.

### 4.2.6 Category of staff

Respondents were asked to reveal their categories and the results are shown in the table below;

**Table 4.7 Category of staff**

| Category | Frequency | Percentage |
| --- | --- | --- |
| Top management | 10 | 13.7% |
| Middle level managers | 20 | 27.4% |
| Operational staff | 43 | 58.9% |
| **Total** | **73** | **100.0%** |

***Source: Primary data (2017)***

The study findings in the table 4.7 revealed that 13.7% of the respondents were under top management, 27.4% were middle level manager and 58.9% were operational staffs. This implies that all employees from different managerial levels were involved in the study so as to obtain relevant information.

### 4.3 Findings on Working Capital Management and Profitability

The findings were based on the study to investigate the effect of working capital management on the profitability of MCL. According to the findings, they were analyzed basing on Mean and Standard deviation. For the variable with the mean which is below 2.5 show an agreement and above 2.5 show a disagreement with the variable. The results were arranged basing on the study objectives.

#### 4.3.1 Inventory management and profitability

The study researcher examined the effect of inventory management on profitability of Movit Company limited using descriptive statements and the following findings were attained as presented in the table 4.8 that follow. These study findings in respect of mean and standards are interpreted in reference to the measurement scale presented in the table 3.1.

**Table 4.8: Showing mean and standard deviation of the role played by inventory towards profitability**

| Inventory Management | N | Max | Min | Mean | Std. Dev. |
|---|---|---|---|---|---|
| The company has computerized all inventory management system | 73 | 5 | 1 | 3.07 | 1.289 |
| The company utilizes stock taking methods | 73 | 5 | 1 | 3.51 | 1.345 |
| The company has constant supplier of raw materials | 73 | 5 | 1 | 3.15 | 1.568 |
| The company has strong control methods of stock | 73 | 5 | 1 | 3.53 | 1.399 |
| The company uses Just in Time purchasing system where no safety stock are kept | 73 | 5 | 1 | 3.51 | 1.502 |
| The company has enough space for storing raw materials, goods in process and finished good. | 73 | 5 | 1 | 3.84 | 0.996 |
| ***Valid N (list wise)*** | 73 | | | | |

**Source: primary data (2017)**

**4.3.1.1 Movit Company Limited has a computerized inventory management system.**

From the findings in the table 4.8 above, it is clearly evident that respondents were indifferent about the existence of an effective inventory management system at Movit Company Limited in that a significant value of 3.07 was attained which fall in the neutral range on the likert scale. This implies that the company moderately utilizes the computerized inventory management system which is installed in the warehouses and company production premises entitled to track respective batch numbers and quantity records of stock in and stock out periodically.

However, a significant value 1.289 of standard deviation was revealed under the same test

which presented variations in the responses presented by the respondents upon the question. Findings were inline with the arguments of Handey (2006) as he contends that manufacturing companies have many operational inputs and outputs prescribed as raw materials and finished goods to which respective quantities are always targeted. This requires the management to ensure full tracking of inventories in order to ensure operations consistency and efficiency.

**4.3.1.2 The company utilizes stock taking methods.**

The study findings presented in the table 4.8 above revealed that respondents agreed that the company always utilize the stock taking methods as a mean value of 3.51 was obtained which is under the agreement range on the linkert scale of rating. This implies that stock taking methods that entail record taking, evaluations and analysis is done by the company in order to manage appropriate inventories held by the company.

However, a significant value 1.345 of standard deviation was revealed under the same test which presented in the variations in the responses provided by the respondents. The study findings were inline with the arguments of Roumiantsev and Netessine (2005) as they argued that manufacturing companies do take different records in form of invoices, production checklists, delivery slips among others which do define the stock purchased and held by the company within a given trading period.

**4.3.1.3 The company has constant suppliers of raw materials.**

The study findings presented in the table 4.8 above, the study respondents were indifferent about the attainment of constantly suppliers of raw materials used in the production units of the company in that a significant mean value of 3.15 was obtained which is under the moderate or neutral range on the likert scale of rating. This implies that Movit company limited attains its supplies from different potential supplies often without sticking on one supplying firm and this is done to ensure consistency in the supplies. A significant value

1.568 of standard deviation was also obtained which shows that there are variations in the responses provided by the respondents.

#### 4.3.1.4 The company has strong control methods on stock.

From the findings presented in the table 4.8 above revealed that respondents agreed that the company has a strong control methods of stock in that, a significant mean value of 3.53 was obtained which implies that Movit Company limited has got strong stock control methods integrated in its internal control systems and business regulation policies followed by respective employees within the company concerned with stock control and management.

However, a significant value 1.502 of standard deviation was revealed under the same test which presented variations in the responses provided by the respondents upon the questions being administered.

#### 4.3.1.5 The company uses just in time purchasing system where no safety stock are kept.

The study findings presented in the table 4.8 revealed that respondents agreed that the company uses just in time purchasing system where no safety stock are kept whereby a mean value of 3.51 was obtained which lies to the agreement range on the likert scale of rating. A significant value 1.502 of standard deviation was also revealed under the same test which presented variations in the responses provided by the respondents.

#### 4.3.1.6 The company has enough space for storing raw materials, goods in process and finished good.

The study findings presented in the table 4.8 above revealed that respondents agreed that the company has enough space for storing raw materials purchased, goods in production progress and finished goods ready for deliveries in that a significant mean value of 3.84 was revealed which is under the agreement range on the linkert scale of rating.

However, a significant value 0.996 of standard deviation was revealed under the same test which presented variations in the responses provided by the respondents. Findings were inline with the arguments of Pandey (2005) as he contends that there are various classified forms in which inventories exist in a manufacturing company as: raw materials, work-in-progress and finished goods. Stocks of raw materials and work-in-progress facilitate production, while stock of finished goods is required for smooth marketing operations

In addition, one of the employees said that "*The objective of inventory management should be to determine and maintain optimum level of inventory investment which should normally lie between the two danger points of excessive and inadequate inventories*". Inventory, therefore, plays an important role to determine the activities in producing, marketing and purchasing. Since inventory determines the level of activities in a company, managing it strategically contributes to profitability.

### 4.3.2 Cash Management and Profitability

The study examined the influence of cash management on profitability of Movit Company limited and the following findings were obtained. These study findings in respect of mean and standards are interpreted in reference to the measurement scale presented in the table 3.1.

**Table 4.9: showing mean and standard deviation of cash management and profitability**

| Cash Management | N | Max | Min | Mean | Std. Dev. |
|---|---|---|---|---|---|
| The company has a strong budget control system | 73 | 5 | 2 | 4.71 | 1.595 |
| The company is quick on recovering its debt | 73 | 5 | 1 | 3.05 | 1.458 |
| Cash budgets are drawn for the business | 73 | 5 | 1 | 4.09 | 1.391 |
| The company requisitions for all expenses and payments to be made | 73 | 5 | 2 | 4.59 | 1.296 |
| It is important to keep records of cash management in the Business | 73 | 5 | 1 | 4.18 | 1.531 |
| The business keeps financial records | 73 | 5 | 1 | 4.80 | 1.161 |
| Cash flow is managed easily in the business | 73 | 5 | 1 | 3.85 | 1.399 |
| Valid N (list wise) | 73 | | | | |

***Source: Primary data (2017)***

#### 4.3.2.1 Company has strong budget control systems.

Results presented in the table 4.9 above, it is evident that respondents agreed about the company's possession of a strong budget control system whereby a significant mean value of 4.71 which in the agreement range on the likert scale of rating. This implies that the management of Movit Company Limited applies technical expertise in dealing with budgets and utilizes it as managerial tool in managing and controlling financial resources.

Findings were inline with the arguments of Pandey (2004) contends that cash management is

seen as one of the key aspects of efficient working capital management and entails planning and controlling cash flows into and out the business, cash flows within the business, and cash balances held by a business at a point in time.

#### 4.3.2.2 The company is quick on recovering its debt.

Findings presented in the table 4.9 above, it is revealed that respondents were indifferent about the capacity of the management of Movit Company Limited in recovering debts from customers as a mean value of 3.05 was attained which affirms neutrality and moderate status upon the managerial approaches. However, a significant value 1.458 of standard deviation was revealed under the same test which presented variations in the responses of the respondents.

#### 4.3.2.3 Cash budgets are drawn for the business.

Findings presented in the table 4.9 revealed that respondents agreed that the company requisitions for all expenses and payments to be made whereby a mean value of 4.09 in that the management of Movit Company Limited draws cash budgets for the business expenses and operations.

However, a significant value 1.391 of standard deviation was revealed under the same test which presented variations in the responses provided by the respondents. Findings were inline with the arguments of Wetson and Copeland (2008) as they contend that cash management is concerned with optimizing the amount of cash available, maximizing the interest earned by spare funds not required immediately and reducing losses caused by delays in the transmission of funds.

Holding cash to meet short term needs incurs an opportunity cost equal to the return which could have been earned if the cash had been invested or put to productive use.

#### 4.3.2.4 The company requisitions for all expense and payments to be made.

Findings presented in the table 4.9 above revealed that respondents agreed that the Movit Company limited requests for all expenses and payments to be made or made after in that a significant mean value of 4.59 was revealed which in the agreement range on the likert scale of rating. However, a significant value 1.296 of standard deviation was revealed under the same test which presents variation in the responses provided by the respondent.

#### 4.3.2.5 It is important to keep its records of cash management in the business.

Findings presented in the table 4.9 revealed that respondents agreed that the Movit Company Limited keep records regarding cash at hand and cash in hand in that a high mean value of 4.59 which is in the agreement on the linkert scale of rating. However a significant value of standard deviation with 1.531 which presents variations in the responses provided by the respondents upon the same test.

#### 4.3.2.6 Business keeps financial records.

Findings that are presented in the table 4.9 above revealed that respondents agreed that Movit Company Limited normally takes all financial records for further managerial techniques and usage measures to effectively cover different functions in that a significant mean value 4.18 was obtained which in the agreement range on the linkert scale of rating. However, a significant value 4.80 of standard deviation was obtain which implies that responses from respondents varied as expressed with the ranges of 5 to 1 in the tabulated results.

#### 4.3.2.7 Cash Flow is managed easily in the business.

Findings presented in the table 4.9 above revealed that respondents agreed that cash flow is easily managed by Movit Company Limited in that a high mean value of 3.85 was obtained which in the agreement range on the linkert scale of rating. However, a significant value 1.399 of standard deviation was revealed under the same test which presented variations in

the responses provided by the respondents.

Findings were inline with the arguments of Weston and Copeland (2008) stated that companies need a cash reserve in order to balance short term cash inflows and outflows since these are not perfectly matched. This they referred to as the transactions motive for holding cash, where the approximate size of the cash can be estimated by forecasting cash inflows and outflows and by preparing cash budgets

On the other hand, the Finance Manager said that, *"Companies hold cash in order to bridge the interval between the time of incurring business cost and that of the receipt of the sale-proceeds"*. In other words, companies hold a certain amount of cash in order to meet the regular expenses of their activity. Therefore, the higher the firm's ability to schedule its cash flows (depending on their predictability), the weaker the transactions-motive for holding cash would be. This is in line with the revolution of Weston and Copeland (2008), it stated that companies need a cash reserve in order to balance short term cash inflows and outflows since these are not perfectly matched. This they referred to as the transactions motive for holding cash, where the approximate size of the cash can be estimated by forecasting cash inflows and outflows and by preparing cash budgets so as to yield more profitability for the company.

In support of quantitative results, "*one of the respondents said that cash is much more than just one element of working capital*". Cash provides the linkage between all financial aspects of the company. More specifically it links short-and long-term financing decisions with one another, with decisions involving investment both in fixed assets and working capital so as to increase on the profitability of the company. However, according to Moyer, et al, (1992), he observed that cash and marketable securities are the most liquid of the company's assets. Cash is the sum of currency a company has on hand and the funds on deposit in bank checking accounts. Cash is the medium of exchange that permits management to carry on the

various functions of the business which in turn leads to an increase in the profitability levels.

### 4.3.3 Accounts receivables and profitability

The study examined the influence of accounts receivables and profitability of Movit Company limited and the following findings were obtained. These study findings in respect of mean and standards are interpreted in reference to the measurement scale presented in the table 3.1.

**Table 4.10: showing mean and standard deviation of accounts payable and profitability**

| Accounts receivables | N | Max | Min | Mean | Std. Dev. |
|---|---|---|---|---|---|
| The company is good at recovering its debts | 73 | 5 | 1 | 3.29 | 1.449 |
| The company offers cash discount for early credit payments | 73 | 5 | 1 | 3.84 | 1.596 |
| The company has receivables management policy that is used to select customers | 73 | 5 | 1 | 3.98 | 1.604 |
| All customers pay back their amount due | 73 | 5 | 1 | 4.24 | 1.504 |
| Credit control department collects and receives payments | 73 | 5 | 1 | 3.85 | 1.161 |
| The company has accurate records for debtors who normally take goods on credit | 73 | 5 | 1 | 3.65 | 1.305 |
| Valid N (list wise) | 73 | | | | |

***Source: Primary source (2017)***

#### 4.3.3.1 The company is good at recovering its debts.

Findings presented in the table 4.10 above revealed that Movit Company limited is able to attain good levels of debt recovery in that corrective procedure and steps are taken by the concerned organisational staff. This is presented by a significant mean value of 3.29 which

lies to agreement range on the linkert scale of rating. However, a significant value 1.449 of standard deviation was revealed under the same test which presented variations in the responses provided by the respondents.

In addition to that, the respondents also emphasized that, the objective of debtors (receivables) management is to minimize the time-lapse between completion of sales and receipt of payments. The company is able to recover its debts regardless of having clear records of the company debtors. This is in contrary with the early revolutions of Rafuse (1996) which stated that the management of accounts receivable is largely influence by the credit policy and collection procedure in order to recover all the debts so as to increase on the profitability.

**4.3.3.2 The company offers cash discounts for early credit payments.**

Findings presented in the table 4.10 revealed that the company offers different cash discounts for early credit payments in early time periods whereby a significant mean value of 3.84 which in the agreement range on the linkert scale of rating which implies Movit Company Limited has different offer packages established to cater for debt payment rates.

However, a significant value 1.596 of standard deviation was revealed under the same test which presents variations in the responses provided by the respondents. Findings were inline with the arguments of Berry and Jarvis (2006) assert that a firm setting up a policy for determining the optimal amount of accounts receivable have to take into account the trade-off between the securing of sales and profits and the amount of opportunity cost and administrative costs of the increasing accounts receivable; the level of risk the firm is prepared to take when extending credit to the customer because the customer could default when payment is due and the investment in debt collection management.

#### 4.3.3.3 The company has receivables management policy that is used to select customers.

Findings being presented in the table 4.10 above revealed that Movit Company limited has got recievables management policy that is implemented in order attain effective financial resource management of the institution in order to full sustain company pride and optimized financial performance all round. This is evident with a significant mean value of 3.98 which in the agreement range on the linkert scale of rating though a significant value of 1.604 of standard deviation was revealed under the same test.

#### 4.3.3.4 All customers pay back their amount due.

Findings being presented in the table 4.10 revealed that all customers of Movit Company limited as respondents mean computations are it the agreement range on the likert scale of rating whit a value of 4.24. However, a significant value 1.504 of standard deviation was revealed under the same test which presented variations in the responses provided by the respondents.

#### 4.3.3.5 Credit control department collects and receives payments.

Findings being presented in the table 4.10 revealed that the credit control department of Movit Products limited is able to gather a recognizable debt recovery as it receives payments from the customers who have debts unpaid whereby a significant mean value 3.85 was revealed under the same test which presented variations in the responses provided by the respondents.

#### 4.3.3.6 The company has accurate records for debtors who normally take goods on credit.

Findings being presented in the table 4.10 revealed that the company has got goods records regarding bad debtors in the credit department with the intention of marginalizing their continued possibility of borrowing from the institution which subjects the management to

more debts which are hard to be recovered both in short or long run. This is evident with a significant mean value of 3.65 which is in the agreement range on the likert scale of rating. However, a significant value 1.305 of standard deviation was revealed under the same tests which presented variations in the responses provided by the respondents upon the query.

In regard to the oral interview, the respondents revealed that receivables stimulate sales because it allows customers to assess product quality before paying but on the other hand, debtors involve funds which is an opportunity costs. Based on the characteristic of accounts receivable the element of risk, economic value and futurity explains the basis and need for efficient management of receivables so as to increase on the profitability levels of the company.

On the other hand, one of the managers said that, "*setting up policies of debt management comes with its own costs which can lead to an increase in the cash outflow of the company"*. And this might not affect the company's profitability indirectly. This is in line with the early revolutions of Berry and Jarvis (2006) which assert that a firm setting up a policy for determining the optimal amount of accounts receivable have to take into account the trade-off between the securing of sales and profits and the amount of opportunity cost and administrative costs of the increasing accounts receivable; the level of risk the firm is prepared to take when extending credit to the customer because the customer could default when payment is due and the investment in debt collection management.

### 4.4 Correlation Analysis

To show the relationship between study variables, a correlation analysis was made and the results are presented in the table below;

**Table 4.11: showing the relationship between working capital management and profitability**

| | | Working Capital Management | Profitability |
|---|---|---|---|
| **Working Capital Management** | Pearson correlation (r) | 1.000 | .787** |
| | Sig. (2-tailed) | .. | 0.002 |
| | N | 73 | 73 |
| **Profitability** | Pearson correlation (r) | .787** | 1.000 |
| | Sig. (2-tailed) | 0.002 | .. |
| | N | 73 | 73 |

***Source: Primary data (2017)***

The table above shows Pearson's correlation r =0.7872** between Working Capital Management and profitability of manufacturing companies. Suggesting that the two variables are were positively related. The Pearson's correlation coefficient r=0.7872** and P or significance value (P=0.002) shows that there was a high significant positive relationship between WCM and profitability of Movit Company Limited. Therefore when the company improves on its WCM, there would be an increase in the profitability levels.

According to the Finance Manager, the level of investment in current assets has a bearing on the profitability of the firm. Excess of investment in working capital casts a negative impact on the profitability of a firm and positive impact on the liquidity. This is in line with the revolutions of Horne and Wachowicz, (2000) which Firms with too few current assets may incur shortages and difficulties in maintaining smooth operations Efficient working capital management involves planning and controlling current assets and current liabilities in a manner that eliminates the risk of inability to meet short term obligations due on one hand

and avoiding excessive investment in these assets on the other hand (Eljelly, 2004).

On the other hand, the respondents also emphasized that good working capital management leads to increased cash flows, and thus leads to lesser need on external financing and the probability of default for the firm will be reduced. Efficient utilization of f company's resources and better management of receivables lead to efficient day to day operations of the company hence leading to increase in the profitability.

### 4.5 Conclusion

The study findings revealed that working capital management and profitability have Pearson's correlation value of 0.787. This implies that there is a strong relationship between working capital management and profitability of manufacturing companies. Therefore these findings are in line with the earlier revelations made by Wang (2002) which states that the way working capital is managed has a significant impact on the profitability of the firm and lead to an increase in profitability by reducing on the accounts receivable and reducing inventory.

# CHAPTER FIVE

# SUMMARY CONSLUSION AND RECOMMENDATIONS

## 5.0 Introduction

This chapter presents the summary of the findings presented in chapter four, conclusions and recommendations of the study. The recommendations were given by the respondents in their different capacities as well as the researcher.

## 5.1 Summary of findings

### 5.1.1 Inventory management and profitability

The results revealed that Movit Company Limited does not put into consideration inventory management. The firm is faced with the problem of maintaining large size of inventory of raw materials, work in progress and finished goods to enhance uninterrupted sales operations.

### 5.1.2 Cash management and profitability

The results revealed that, MCL emphasizes cash flow management which helps the company to synchronize cash inflows with cash outflows by using cash budgeting and forecasting in formulating cash management strategy which in turn leads to an increase in the profitability levels of the company.

### 5.1.3 Accounts receivables and profitability

The results on the role played by accounts receivable on the profitability revealed that the objective of debtors (receivables) management is to minimize the time-lapse between completion of sales and receipt of payments. The company is able to recover its debts regardless of having clear records of the company debtors hence increasing on the profitable of the company.

### 5.2 Conclusions

Inventory management comprise of coordination of materials controlling, utilization and purchasing. Companies need to get the right inventory at the right place in the right time with right quantity because it is directly connected with the production of goods which in turn leads to an increase in the profitability levels.

Cash provides the linkage between all financial aspects of the company. More specifically it links short-and long-term financing decisions with one another. Decision making involves investment both in fixed assets and working capital so as to increase on the profitability of the company. Companies hold a certain amount of cash in order to meet the regular expenses of their activity. Therefore Companies should forecast their cash inflows and outflows by preparing cash budgets so as to yield more profitability for the company.

Setting up policies of debt management comes with its own costs which can lead to an increase in the cash outflow of the company. And this might affect the company's profitability indirectly. Therefore the company setting up a policy for determining the optimal amount of accounts receivable has to put into consideration the costs and risks associated with securing of sales and profits to be obtained.

Working Capital Management and Profitability of the company as it is revealed by Pearson correlation coefficient as $r=.7872$, $p= 0.01$ which is significant. The level of investment in current assets has a bearing on the profitability of the firm. Excess of investment in working capital casts a negative impact on the profitability of a firm and positive impact on the liquidity. Firms with too few current assets may incur shortages and difficulties in maintaining smooth operations. Therefore companies should plan and control their current assets and current liabilities in a manner that eliminates the risk of inability to meet short term obligations due and avoiding excessive investment in these assets.

## 5.3 Recommendations

In light of the research findings, the following recommendations were made.

Companies should focus on the products or services with the highest gross profit margin since they are the most important to the business as they generate more money. Once they identified the most profitable items, they should concentrate on achieving higher sales targets for them. This may require them to rethink aspects of the business or to devise strategies for improvement so as to increase on the profitable levels.

Physical count of inventory is an important measure for improving inventory management control. No matter what inventory system a business uses and how well it keeps the inventory records, losses of actual inventory because of theft, breakage or waste are always a possibility and may not be reported and recorded in the inventory account in a timely fashion. A year-end or periodic physical count of inventory helps uncover the potential difference between the amount of actual inventory available and the amount of inventory recorded in the inventory account. Without such information, inventory management control may be misguided.

## 5.4 Areas of further research

Further research may be carried out comprising of other variables to predict their impact on the profitability of manufacturing companies.

The impact of inventory management practices on the profitability of the company. This is because researcher did not exhaust its impact on the level of profitability.

The study concentrated on the effect of working capital management on the profitability of manufacturing companies. Further research should attempt to widen the scope of the study to cover other sectors other than the industrial sector that is to say manufacturing industries.

## REFERENCES

Arnold, G. (2008*). Corporate financial management*. Pearson education limited, 4th edition

Boundle, W. 2015. Bureaucratic Organizations: Weber. *Boundless Management*. Boundless, 21 Jul. 2015. Retrieved 04 Oct. 2015.

Bouie, E. L. Jr, 2012. The Impact of Bureaucratic Structure, Scientific Management and Institutionalism on Standards – Based Educational Reform. *Mercer Journal of Educational Leadership*, (E-journal).Vol.1, No.1.

Deloof, M. (2003); Does Working Capital Affect Profitability of Belgian firms? *Journal of Business, Finance and Accounting* 30(3&4):573-587.

Eljelly, A.M.A (2004): *Liquidity-Profitability Trade-off:* An Empirical Investigation in an

Emerging

Filbeck, G., & Krueger, T. M. (2005).*An analysis of working capital management results across industries*. American Journal of Business, 20(2), 11-20.

Gakure, R., Cheluget, K.J. Onyango, J.A, &Keraro, V. (2012).*Working capital management and profitability of manufacturing firms listed at the Nairobi stock exchange*. Prime Journal of Business Administration and Management (BAM), 2 (9), 680-686.

Honingh, M.E. andHooge, E.H., 2009. Reconsidering the tension between bureaucracy and professionalism in publicly and privately funded schools. *Social Leadership Management*, Vol. 29, No.4, pp. 405 – 420.

Kwame, F.A., 2011. *The Impact of Bureaucracy on Public Service Delivery: A study of Kumasi Metropolitan Assembly*. (Bachelor' Degree Thesis).Institute of Distance Learning, Kwame Nkrumah University of Science and Technology.

Ludwig, T. 2004. On *Good and Bad Bureaucracies: Designing Effective Quality Management Systems in the Agrofood Sector*. Georg-August University, Gottingem.

Mathuva, D.M. (2010). *Influence of working capital management components on corporate profitability*: A survey on Kenyan listed firms. Research Journal of Business Management 3(1), 1-11.

Ministry of Finance, Planning and Economic Development (MoFPED) Report 2014.*Human Resource Annual Report: Ensuring Effective Management among employees*. [Leaflet] September, 2014 ed. Ministry of Finance, Planning and Economic Development.

Nyabwanga, R.N., Ojera, P., Lumumba, M., Odondo, A.J., &Otieno, S. (2012). *Effect of working capital management practices on financial performance:* A study of small scale enterprises in Kisii South District, Kenya. African Journal of Business Management, 6(18) 5807-5817

Omesa, N. W., Maniagi, G. M., Musiega, D., &Makori, G.A. (2013). Working capital management and corporate performance: Special reference to manufacturing firms on Nairobi Securities Exchange. *International Journal of Innovative Research and Development*, 2(9), 177-183

Raheman, A., & Nasr, M. (2007).Working capital management and profitability–case of Pakistani firms. *International Review of business research papers*, 3(1), 279-300

Riggio, R. E., Dr., 2010. *The Negative Effects of Bureaucracy*. Posted on November 9, 2010

Smith, M. B. and Begemann, E (1997).Measuring Association between working capital and return on investment. *South African Journal of Business Management* 28(1):1-5

Osisioma, B. (1997). Sources and management of working capital. *Journal of Management Sciences*, Awka, 2(1).

Smith, K. (1980). Profitability versus Liquidity Tradeoffs in Working Capital Management, Readings on the Management of Working Capital. West Publishing Company, New York, St. Paul.

Van Horne, J.C. (1977). A risk-return analysis of a firm's working capital position. Eng.Econ., 71-88.

## APPENDIX I

## QUESTIONNAIRE

**Dear Respondent;**

My name is Bakkabulindi Mwazi James, a student at Uganda Martyrs University pursuing a degree in Business Administration and Management. This questionnaire is part of a project work required by University as a partial requirement for the award of Bachelor's Degree. The questionnaire is designed to solicit your independent views on "the effect of Working Capital Management on Profitability of an Organization, case study of Movit Company Limited. Kindly spare some time and circle or tick or indicate your opinion on each of the statements given. All information provided shall be treated as confidential and used strictly for Academic purpose.

**Section A**

**Background Information**

1. Gender

Male ☐ Female ☐

2. Age group

Below 25 ☐ 25- 30 years ☐ 31- 40 years ☐

41-50 years ☐ 51 and above ☐

3. Which department of the company do you work?

Production ☐ Stores ☐ Finance ☐

Sales and Marketing ☐ Other, please specify................................................

4. Duration of employment

Less than 5 years ☐ 5-10 years ☐ 10-15 years ☐

15 years and above ☐

5. Education level

Primary level ☐ Secondary level ☐ Certificate ☐

Diploma ☐ Degree and above ☐ Other, please specify..............................

**SECTION B. Inventory Management Practices**

Please read the following statements and tick any one of the scores mentioned below:

**5.** Strongly Agree **4.**Agree **3.**Neutral **2.**Disagree **1.**Strongly Disagree

| NO | Description | SA | A | N | SD | D |
|---|---|---|---|---|---|---|
| **1** | The company has computerized all inventory management system | | | | | |
| **2** | The company utilizes stock taking methods | | | | | |
| **3** | The company has constant supplier of raw materials | | | | | |
| **4** | The company has strong control methods of stock | | | | | |
| **5** | The company uses just in time(JIT) purchasing system where no safety stock are kept) | | | | | |
| **6** | The company has enough space for storing raw materials, goods in process and finished goods | | | | | |
| **7** | Involving suppliers in product design process | | | | | |

**SECTION C. Cash management and profitability**

Please read the following statements and tick any one of the scores mentioned below:

**5.** Strongly Agree **4.**Agree **3.**Neutral **2.**Disagree **1.**Strongly Disagree

| NO | Description | SA | A | N | SD | D |
|---|---|---|---|---|---|---|
| **1** | The company has a strong budget control system | | | | | |
| **2** | The company is quick on recovering its debts | | | | | |
| **3** | Cash budgets are drawn for the business | | | | | |
| **4** | The company requisitions for all expenses and payments to be made | | | | | |
| **5** | It is important to keep records of cash management in the business | | | | | |
| **6** | The business keeps financial records | | | | | |
| **7** | Cash flow is managed easily in the business | | | | | |

## SECTION D: Accounts Receivable and profitability

Please read the following statements and tick any one of the scores mentioned below:

**5.** Strongly Agree **4.**Agree **3.**Neutral **2.**Disagree **1.**Strongly Disagree

| NO | Description | SA | A | N | SD | D |
|---|---|---|---|---|---|---|
| 1 | The company is good at recovering its debts | | | | | |
| 2 | The company offers cash discount for early payment of credit | | | | | |
| 3 | The company has receivables management policy that is used to select customers | | | | | |
| 4 | All customers pay back their amounts due | | | | | |
| 5 | The company experiences bad debt losses | | | | | |
| 6 | Credit control department collects and receives payments | | | | | |
| 7 | The company has accurate records for debtors | | | | | |

***Thanks for your time and valuable responses***

## APPENDIX II: INTERVIEW GUIDE

What are the effects of working capital management on the profitability of Movit Company limited?

What are some of the challenges faced during working capital management?

What are the other factors that affect profitability of Movit Company limited?

What are effects of Inventory management practices on the profitability of Movit Company Limited?

How does Cash Management affect profitability of Movit Company limited?

## APPENDIX III

## RV. KREJCIE AND D. W. MORGAN (1970) SAMPLE SIZE ESTIMATION TABLE

| *N** | *S*† | *N* | *S* | *N* | *S* | *N* | *S* | *N* | *S* |
|---|---|---|---|---|---|---|---|---|---|
| 10 | 10 | 100 | 80 | 280 | 162 | 800 | 260 | 2800 | 338 |
| 15 | 14 | 110 | 86 | 290 | 165 | 850 | 265 | 3000 | 341 |
| 20 | 19 | 120 | 92 | 300 | 169 | 900 | 269 | 3500 | 346 |
| 25 | 24 | 130 | 97 | 320 | 175 | 950 | 274 | 4000 | 351 |
| 30 | 28 | 140 | 103 | 340 | 181 | 1000 | 278 | 4500 | 354 |
| 35 | 32 | 150 | 108 | 360 | 186 | 1100 | 285 | 5000 | 357 |
| 40 | 36 | 160 | 113 | 380 | 191 | 1200 | 291 | 6000 | 361 |
| 45 | 40 | 170 | 118 | 400 | 196 | 1300 | 297 | 7000 | 364 |
| 50 | 44 | 180 | 123 | 420 | 201 | 1400 | 302 | 8000 | 367 |
| 55 | 48 | 190 | 127 | 440 | 205 | 1500 | 306 | 9000 | 368 |
| 60 | 52 | 200 | 132 | 460 | 210 | 1600 | 310 | 10000 | 370 |
| 65 | 56 | 210 | 136 | 480 | 214 | 1700 | 313 | 15000 | 375 |
| 70 | 59 | 220 | 140 | 500 | 217 | 1800 | 317 | 20000 | 377 |
| 75 | 63 | 230 | 144 | 550 | 226 | 1900 | 320 | 30000 | 379 |
| 80 | 66 | 240 | 148 | 600 | 234 | 2000 | 322 | 40000 | 380 |
| 85 | 70 | 250 | 152 | 650 | 242 | 2200 | 327 | 50000 | 381 |
| 90 | 73 | 260 | 155 | 700 | 248 | 2400 | 331 | 75000 | 382 |
| 95 | 76 | 270 | 159 | 750 | 254 | 2600 | 335 | 1000000 | 384 |