



MANAGEMENT OF DAY TO DAY CAPITAL BY SMALL AND MEDIUM ENTERPRISES IN GUJARAT : A SURVEY OF BUSINESS OWNERS

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ABSTRACT

Working capital Management occupies a great significance in business. Small and Medium Enterprises (SMEs) are playing key role in the development of economy. Government takes many steps for supporting SMEs still they face problems of liquidity management. The purpose of this study is to analyze the actions owner-managers of small businesses undertake in managing working capital. The study is qualitative in nature. Interviews of small business owners in Gujarat has been conducted for identifying their methods, problems and challenges while managing for working capital. The study concludes that small business owners do not go for formal process of working capital management.

Keywords - Working capital management, Small and Medium Scale Enterprises (SMEs), Qualitative research

Introduction and need of the study

Working capital management plays an important role in success and failure of firm in business because of its effect on firm's profitability as well as on liquidity. Working capital consists of investments in current assets, which includes short term assets – cash and, inventories, receivable and marketable securities. The finance manager is constantly engaged in endeavoring to maintain

a sound working capital position. Excessive Working capital leads to wasteful use of scarce resources and inadequate working capital interrupts the smooth flow of business activity and profitability. The survival and growth of the company depends on the ability to meet two vital aspects of working capital management i.e profitability and liquidity.

Objectives of the Study

1. To analyze the ways of managing working capital of selected SMEs.
2. To examine the actions taken by managers/owners of small businesses for managing working capital.
3. To analyze the problems faced by small businesses while managing working capital.
4. To identify measures for improving the efficiency of working capital management.

Benefits/outcome of the study

The company has to maintain an optimum level of liquidity to run the business on a continuous basis without any interruption. If the liquid assets are adequate to pay off the current liabilities, financial soundness is automatically created and its credit reputations are sustained. WCM is concerned with the problems that arise in attempting to manage the current assets, current liabilities and the inter relationship that arise between them. Efficient working capital management is an integral component of the overall corporate strategy to create shareholder value. The research paper would not only seek to understand the correlation between WCM and profitability but would also try to probe into the factors to be considered while making working capital decision hence providing useful guidelines for the firms with respect to managing working capital.

Research Gap

Previous studies have tended to focus on the use of financial reports disregarding behavior, which drives management processes and as a result, our empirical knowledge of working capital management is still limited. This study attempts to develop an in-depth understanding on how managers manage working capital. Owner-managers of small businesses do not require the same degree of sophistication employed in planning, monitoring and controlling working capital. They require soft skills. Therefore, academicians, practitioners and policy makers need to emphasize knowledge management and cash accounting. This study examines the process perspective of

working capital management, an aspect that has not been adequately highlighted in previous studies.

Literature review

Singhania Monica, Sharma Navendu & Yagnesh Rohit (2014) have examined the relationship between working capital management strategies of a firm and its profitability. They have applied correlation analysis and fixed effects estimation on their sample of Indian manufacturing companies. Cash conversion cycle has been utilized as a measure of the working capital management, whereas gross operating profit is used as a proxy for a firm's profitability. Furthermore, interactive dummies are utilized to investigate the impact of global macroeconomic conditions on the relationship under consideration. The results reveal that cash conversion cycle of a company has a negative correlation with its profitability. The findings highlight the importance of efficient working capital management practices to improve the profitability of companies

Dorisz Tala (2014) analyses trends in the working capital management of those Hungarian dairy companies that feature the highest levels of sales revenues in the domestic market and diversified product structures. This study has relied on the annual reports, i.e. the balance sheets and profit & loss accounts of the companies for the fiscal period of 2008-2012. The research methodology of the analysis is based on the review of financial indicators internationally accepted and used in connection with working capital management. Moreover, the study determines a cash conversion cycle, and in this context the inventory and receivables turnover, as well as the payables turnover. The closing section of this study summarises the conclusions drawn from the data of the analysis conducted, and the major characteristics of the working capital management for the leading companies of the Hungarian dairy industry with diversified product structures are highlighted.

Vicente Nakamura Palombini Nathalie & Toshiro Nakamura Wilson (2012) have used data from 2,976 Brazilian public companies from 2001 to 2008, and found that debt level, size and growth rate can affect the working capital management of companies. This paper provides insights regarding the key factors of working capital management by exploring the internal variables of a number of companies.

Chakrobarty Nirmal (2013) has undertaken a study to examine the working capital performance of Dr Reddy's Laboratory. Different financial ratios and statistical techniques are also applied for measuring the working capital efficiency. Quick ratio, inventory turnover ratio, Debtors turnover ratio, gross profit ratio, and working capital turnover ratio showed satisfactory performance and current ratio, absolute liquid ratio, operating profit ratio of the company

were not found to be satisfactory. The correlation coefficient between liquidity and profitability of the selected company was observed to be (-) 0.0875.

Laura A. Orobia and Warren Byabashaija Department of Entrepreneurship (2013) attempts to develop an understanding of how businesses manage working capital. As observed by Munene et al. (2005) and Sejjaaka (2005), answering the “how is it done?” Question provides a somewhat deeper understanding of human behavior or actions.

Alavinasab, Seyed Mohammad & Davoudi Esmail (2013) have examined the relationship between working capital management and profitability for listed companies on Tehran stock exchange. 147 companies were selected for the period of 2005-2009. The effect of various variables of working capital management including cash conversion cycle (CCC), the current ratio (CR), current asset to total asset ratio (CATAR), current liabilities to total asset ratio (CLTAR) and debt to asset ratio (DTAR) on return on assets and return on equity were studied. Multivariate regression and Pearson correlation were used to test hypothesis. The results of the statistical test of the hypothesis showed a negative significant relationship exist between cash conversion cycle (CCC) and return on assets and there was also a negative significant relationship between cash conversion cycle (CCC) and return on equity. However, the relationship between current ratio and return on equity was found to be insignificant.

Research methodology

Research design

The study is an exploratory in nature. In-depth interviews of Small Business Owners have been conducted to understand how SMEs manage working capital. The study is qualitative in nature.

Data collection and Research Approach

Primary data has been collected from 15 SME owners through in-depth (semi structured) interviews.

Analysis of data

Out of a total of 15 interviews that were conducted, 9 interviews were audio recorded (remaining 6 respondents did not give permission for audio recording.) After importing the audio recordings into the Nvivo10 software their timeline transcripts were created. The interviews lasted between 45min and one hour.

The interview data were analyzed using content analysis techniques. The data of each interview was color coded according to separate components of working capital management (i.e. cash management, receivables management, payables management and overall business process and working capital management techniques). Queries regarding word frequency were generated. The results like word clusters and word tree were generated and used in content analysis.

After the coding process, the data pertaining to one particular code was analyzed (i.e. pertaining to one aspect of working capital management). This analysis of data pertaining to a particular node helped in establishing relationships between working capital management practices of different companies. The coding process helped in organizing relevant data, data comparison and analysis of transcribed data.

Limitations of study

The research includes only 15 samples. A greater number of samples would yield more accurate results. For the qualitative data, in trying to understand the factors involved in Working Capital Management, the research may not be able to test the effect of personal characteristics on working capital management process. Although the research tries to capture this limitation by audio recording interviews and then trying to understand any personal biases that may involved in the practices of a particular manager, these may not be completely eliminated. The time period of 6 months was not sufficient for a detailed study of the topic.

Analysis

Inventory Management

Under this the transcripts were analyzed to understand the various inventory management practices at the small businesses. It was observed that much of the inventory related decisions were related to the price of the commodity being dealt with apart from the demand for the product.

"Because the supply varies a lot. So at times you may get a material and after some time it may not be available in the market. then you have to buy this at a premium cost. So it is better to store it than to buy it a premium cost."

"We dont do that (stocking of finished goods inventory) because brass market fluctuates very much . Its a big risk to stock them. We have to give on rates as per today's brass market. So if our stock is of expensive brass then what the brass market is today then we would suffer a loss."

Inventory decision of small business owners is also influenced by the framework of competitive forces prevailing in the industry."*but we dont want to suffer for that that we dont have the material and we are not able to supply. Because the competition is very high. so we have to bear this cost"*.

For monitoring the inventory levels, the small business owners would first of all set an inventory limit below which inventory was not allowed to drop. The inventory level was then monitored by comparing the physical count against the set limit on a regular interval.

Rather than being based on inventory models like the EOQ model, the inventory decisions of small business owners were based on storage facilities available with them. Only one of the interviewee who owned two cold storage facilities two facilitate storage of groceries and vegetables to serve 5 restaurants and 3 hotels owned by them in the town, employed sophisticated techniques of inventory. The business had installed an ERP system for inventory management.

Most of the small business owners that supplied their inventories to large scale suppliers received demand schedule from these vendors. This helped them in reducing their burden of demand

forecasting and inventory planning. This helped them in scheduling their production and reducing their finished goods inventory.

"No not really. We first we receive orders. and then we manufacture.

How many suppliers you supply

There are 6 suppliers

You receive all your demand in advance only and then only you plan your production schedule.

Yes we first receive the orders. So you do not have any space to keep or stock your finished goods? No. We don't do that "

"Our inventories are very tightly monitored. There is an ERP system installed which gives real time information of our inventory to not only our suppliers but are all linked directly to the head office of IOC. "

Other factors like setup costs transportation costs also played an important role in affecting inventory decisions. These decision varied from one industry to another. One of the excerpts from the interview of an owner of a spare parts manufacturing unit illustrates this point:

"We get a inventory schedule from the buyer so we have to maintain like basically we supply in part if we have a demand for a particular part 5000 in a month so it is distributed how much you have to deliver per day. If we have to deliver 200 at a particular date so you cannot be producing 200 every day because we have a lot number of parts to be manufactured. If you are making a setup for a part you will produce at least 100. it leads to a inventory of 1 week. Because you will not produce 200 pieces daily and deliver daily. So that cost for setup is borne. So we end up having an inventory."

Receivables Management

Most of the small businesses that were in a B2B supply chain are governed by the policies of major players that are linked to them vertically. For example following are the excerpts of transcripts of two of the OEM suppliers.

" So what is credit policy you have.

Depends on the client.

Sometimes the clients buys very large quantity then he makes the policy."

"You give on credit also

we give on credit only. 90 days policy. Its not our policy its theirs only."

The above quotes establish the fact that the receivables policy of SMEs are governed by the large players that are vertically integrated with them.

Some of the established businesses had their own policies as well. A manufacturer of electrical brass accessories mentioned

"You sometimes ask them to make payment early and give them some discount?

Yes we have that policies. If they can pay in one month then we have discounts.

So you have laid down these in your rules.

Yes"

Most owner-managers granted credit on the basis of their relationship with the customer. Credit was granted to only those customers who were personally known to the managers.

"Generally we ask for advance money when we enter contracts for organizing party. But if say there is a very well known businessman of the town who has asked to make a party arrangement then we won't even ask for any such advance." Quoted the manager of a restaurant and hotel business.

Owners of businesses like government agencies (agency of Indian Oil Corporation) were governed by the policies.

"Let us talk about your credit policy? Do you give goods on credit?

Customers should pre book their cylinders with us and only when we have received the payment do we supply goods. This is rule by the IOC. You should receive empty stocks of cylinders when you supply fresh cylinders.

So you business involves no credit only cash.

Yes"

Small business owners did not use receivable management techniques like factoring of accounts receivable, discounting of bills with the bank, debtor screening etc.

Cash Management

An essential part of working capital management is cash management. Most of the SME owners did not undertake any formal technique of cash management. They did not even prepare cash budgets. Most of them had surplus cash with them to meet their requirements. This surplus cash was usually kept with the bank.

*"You are selling on credit and you are making advance payments at the same time so where do you generate this cash from . You would be having to keep extra cash with you
It comes from past transactions.*

*Then you would have to hoard a lot of cash or you use bank limits, credit limits etc.?
We also use that overdraft limit we need to keep cash also."*

SME's could survive with these because industry competitive forces did not force them to be very efficient with regards to cash management. This can be from the following reply of one of the interviewee

"Ok. So in your industry all those who are your competitors in same horizontal line all of them do like this only.

Yes

They have surplus cash

Yes"

Bank limits, cc limits, bank overdrafts and credit purchase were the most common sources of short term funding.

"How much cash do keep with your-self. How much liquid cash so that you can purchase on hand to cut down interest cost. Generally we maintain a credit limit with the bank. cc with the bank it is around 20 to 30 lacs. Then you will be charged interest on what you use. There is a maximum limit of amount that you can withdraw and depending on how much you use they charge you interest accordingly." Almost all the SMEs used banks solely for investing their surplus idle cash. Only one of them used other short term liquid investments also for investing surplus cash.

"You invest this cash excess somewhere?"

Only bank."

For few businesses which were governed by rules of other entities, the cash flow cycles were very regular and they did not have to undertake much measures to manage cash. Also they were strictly bind by the rules thus they could not do much with the their idle cash.

" deposited into bank whatever we receive and we make whatever payments we require from this amount deposited within the bank. We only had to make an initial investment in the business. Thereafter the flow of funds is very tightly controlled. You receive all payments in advance and you make payment to IOC also in advance."

Conclusion

Working capital management practices of SMEs are much influenced by the big, large scale major players to which the small organization is linked vertically. Also if the organization is in the form an agency then its working capital flows are closely monitored and governed by the governing (principal) authority. SMEs use informal planning in their working capital management. SMEs give more importance to factors like purchase cost availability of goods and competition and give an unduly lesser weightage to factors like cost of holding goods. SMEs do not use conceptual frameworks like EOQ in their working capital management practices. SMEs offer credit to only those enterprises/individuals whom they personally or they are very large scale organizations personally known to them.

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Exhibits

Exhibit 1 Word summary

Word	Length	Count	Weighted Percentage (%)	Similar Words
amount	6	157	2.09	advance, amount, average, base, capacity, case, comes, cycle, date, day, deal, end, fall, fill, first, hold, increase, information, limit, little, load, loads, loss, lot, make, maximum, minimum, month, much, number, past, period, premium, production, quantity, region, risk, set, space, square, supply, term, time, times, today, wait, week, weight
need	4	73	1.56	ask, charge, cost, demand, demanding, demands, involved, involves, need, needs, pressure, require, required, take, taking, want, wants
parts	5	120	1.54	back, base, capacity, capital, cut, cutting, end, face, fill, form, function, hand, head, hold, interest, item, limit, liquid, loan, log, making, material, maximum, metal, minimum, office, open, outside, part, particular, parts, period, pieces, place, process, reduce, region, scrap, separation, sheet, small, spare, stock, storage, store, system, term, terminal, turn, turning
activities	10	138	1.49	activities, back, business, casting, charge, check, consumption, cutting, demand, end, enterprise, first, flow, function, going, hand, head, hold, interest, inventory, involved, land, line, manufacture, manufacturing, market, mechanism, mould, office, open, operation, order, part, period, place, process, production, rule, saving, separation, set, short, supply, try, turn, use, using
period	6	75	1.48	daily, date, day, days, even, extra, fall, flow, may, month, number, past, period, rule, term, time, times, week
get	3	130	1.47	bear, becomes, buy, buying, carry, comes, contracts, cut, deliver, fall, find, fixed, generate, get, gets, getting, going, land, let, make, market, outsource, pay, process, procure, produce, producing, purchase, purchasing, recover, rent, serve, stock, suffer, suffering, take, taking, turn
cylinders	9	21	1.37	cylinder, cylinders
cost	4	93	1.34	cash, charge, cost, credit, deposit, discount,

				expensive, interest, pay, payment, premium, price, prices, rate, terms
communicate	11	127	1.33	ask, book, carry, chart, communicate, credit, day, deliver, delivery, demand, form, give, hand, head, hold, information, item, line, material, number, order, place, plant, production, program, rule, saying, talk, term, thing, time, type, want
make	4	136	1.33	bear, builds, chart, copy, cut, find, fixed, form, fulfill, generate, get, gets, getting, give, gives, hold, innovate, interest, let, machine, make, makes, making, manufacture, mould, pay, place, plan, plant, pressure, produce, producing, program, put, see, sell, serve, set, shape, short, take, taking, working
goods	5	59	1.26	better, change, dependent, depending, depends, fresh, goods, interest, inventory, just, line, load, number, practices, saving, stock
change	6	129	1.23	advance, back, better, carry, cash, change, check, circle, converted, cut, cutting, delivery, discount, empty, fall, fill, find, flow, following, form, get, going, increase, investment, know, load, loss, make, modify, produce, push, recover, reduce, sell, separation, set, stock, suffer, switch, take, try, turn, turning, varies, vary
recieve	7	17	1.17	recieve, recieved, recieving
give	4	130	1.13	advance, back, bank, big, buy, carry, charge, check, deal, deliver, deposit, fill, fulfill, generate, get, give, gives, hand, invest, land, let, loan, lot, meet, open, pay, place, plant, procure, put, rent, sell, serve, spare, stable, stay, stock, supply
rods	4	17	1.13	rod, rods
whole	5	75	1.11	brass, carrier, case, deposit, extra, face, field, form, item, line, load, material, means, mechanism, one, person, plant, production, shape, sheet, someone, square, stay, stock, system, thing, type, weight, whole, working
yes	3	16	1.10	yes
payment	7	65	1.05	cash, credit, deposit, discount, pay, payment, payments, premium
information	11	68	0.96	average, book, brief, case, check, copy, daily, everyday, example, forecast, give, information, inventory, item, loose, material, particular, program, schedule, send, talk, tell,

				time
person	6	57	0.96	ace, bear, better, carrier, case, client, company, competition, customer, date, day, dealer, dependent, distributor, face, fan, fellow, head, jinx, land, longer, lot, machine, material, part, person, persons, someone, square, tell, type
idea	4	72	0.89	amount, credit, dimension, end, example, form, idea, part, period, plan, policy, program, quality, quantity, rule, schedule, system, term, thing, thought, turn, whole
many	4	13	0.89	many
days	4	29	0.86	date, day, days, even, today
number	6	36	0.85	100, 500, ace, base, dimension, extra, first, number, one, real, square, turn, turning, two, weight
also	4	12	0.82	also
modify	6	105	0.82	advance, back, better, change, charge, check, cut, dimension, empty, end, even, fill, form, get, increase, land, let, limit, line, load, loose, make, market, modify, number, people, process, reduce, scrap, set, shape, square, stay, switch, time, vary
quality	7	57	0.81	better, capacity, change, check, cost, face, finishing, flexibility, form, function, hold, interest, making, mould, price, quality, shape, system, use
commercial	10	47	0.80	business, commercial, field, industry, investing, investment, manufacture, market, payment, production, sell, selling, storage
hold	4	60	0.79	avoid, bear, carry, find, hoard, hold, keep, land, money, pay, rule, square, stock, store, wait, warehouse
thing	5	39	0.76	back, base, change, cutting, need, part, process, region, scrap, small, system, thing, want
stock	5	42	0.69	base, carry, carrying, funds, hoard, inventories, inventory, line, people, plant, stock, stocks, store, stores, storing
process	7	59	0.67	change, consumption, demand, deposit, flow, increase, loss, mechanism, operation, process, processes, processing, rises, rising, rule, serve, set, supply, till, turn, use, working
working	7	71	0.67	bank, book, capacity, capital, carry, charge, enterprise, factory, fill, form, function,

Exhibit 3 Word tree



