

Working Capital Management Practices of Sri Lankan Manufacturing Companies

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Introduction

This study empirically examines the phenomenon of working capital management practices and motives since the management and control of working capital is one of the most effective measures of Sri Lankan manufacturing company's financial health. In Sri Lanka, manufacturing companies' working capital management practices generally fall under the responsibility of Chief Financial Officers of the companies. In addition, working capital management practices explore stakeholders' expectations and pressures and manufacturing companies in Sri Lanka manage these demands.

Research Problem

Sri Lanka has undergone rapid industrialization since the early 1980's and the per capita income has developed from 2006 to 2011 (Central bank, 2011). Presently, there is a space environment after defeating these decades of terrorism. As a result it could be seen that dramatic development processes are undertaken by the government as well as the private sector. According to central bank report (2011) the economy has also grown by 8.3 percent in 2011, which was the highest in Sri Lanka after independence, maintaining a growth rate more than 8 percent for the first time in two consecutive years and the results of this type of economic development shows manufacturing companies in Sri Lanka should concentrate their working capital management practices because, Sri Lankan manufacturing companies give lots of contributions to the development of the country. Therefore, manufacturing companies in Sri Lanka keeping in view realistic importance of working capital management practices, is attempting to examine the working capital management practices.

Objectives of the Study

- to examine the nature and extend of the relationship between the working capital management practices and performance.
- to develop an understanding of the determinants' variables of working capital management practices on manufacturing companies' performance.
- to give working capital management practices recommendations

Theoretical Considerations and Empirical Evidences

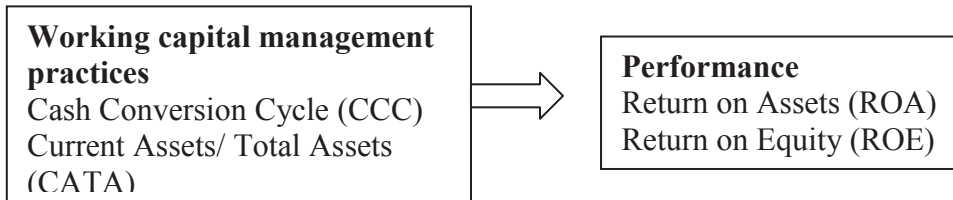
Policies in Working Capital Management

The firm's conservative working capital strategy combines a high level of current assets in relation to sales with a low level of short term financing. Excess amount of current assets enable the firm to absorb sudden fluctuations in sales, production plans and procurement time without disturbing the continuity in production. The higher level of current assets reduces the risk of insolvency. The firm following aggressive working capital strategies would combine a low level of current assets with a high level of short term financing. This firm will have high profitability and greater risk of insolvency. The moderate firm would like to combine moderate level of current assets in relation to sales with moderate level of short term financing to maintain a balance between the risk of insolvency and profitability.

Weinraub and Visscher, (1998) discussed the issue of aggressive and conservative working capital management policies by using quarterly data for the period 1984-1993 of the US firms. Their study considered 10 diverse industry groups to examine the relative relationship between their aggressive/conservative working capital policies. Their study concluded that the industries had distinctive and significantly different working capital management policies. Moreover, the relative nature of the working capital management policies exhibited remarkable stability over the 10-year study period. The study also showed a high and significant negative correlation between industry asset and liability policies and found that when relatively aggressive working capital asset policies are followed, they are balanced by relatively conservative working capital financial policies.

Methodology

Figure 1: Conceptual Framework



Source: Developed by Researcher

Hypothesis of the study

H₀: There is no significant relationship between working capital management practices and performance

H₁: There is a significant negative relationship between working capital management practices and performance

Data Source and Sampling Design

The data used in the study was acquired from the statement of financial position and income statement of the sample manufacturing companies for the period of 2009-2012. The sample of this study is confined to the manufacturing sector consisting of 30 manufacturing companies out of 39 listed in the Colombo Stock Exchange. This represents 78 percent of companies listed under the manufacturing sectors. It will give more validity for the study.

Mode of Analysis

A quantitative research method is employed to arrive at the findings of this study. Correlation and regression analysis are used in the study to examine the nature and extent the relationship and to find out the impact of working capital management practice variables on performance of Sri Lankan manufacturing companies.

Research model

Model 1

$$ROA = \alpha + \beta_1 CCC + \beta_2 CATA + \beta_3 CLTA \quad \text{and} \quad ROE = \alpha + \beta_1 CCC + \beta_2 CATA + \beta_3 CLTA$$

Table 1: Correlation Matrix

Variables	CCC	CATA	CLTA	ROA	ROE
CCC	1				
CATA	0.190 (0.316)	1			
CLTA	-0.378** (0.039)	0.371* (0.044)	1		
ROA	-0.143 (0.451)	0.217 (0.250)	-0.181 (0.339)	1	
ROE	-0.237 (0.208)	0.031 (0.871)	0.049 (0.798)	0.630** (0.000)	1

** , Correlation is significant at the 0.01 level (2-tailed).

* , Correlation is significant at the 0.05 level (2-tailed).

Table 1 shown above displays the correlation values between working capital management practices and performance. The ROE positively correlated with CATA and CLTA. The positive correlation between CATA and CLTA ($r = 0.371^*$) indicates that more current assets are used to finance the total current assets and will have a positive impact on Return on Equity. ROA and ROE are positively correlated with CATA consisting r values of 0.217 and 0.031 respectively. This reveals that maintained by selected 30 manufacturing companies in relation to the total current assets putting the manufacturing companies conservative working capital management policy. In addition, cash conversion cycle is negatively correlated with ROA and ROE consisting of r values of -0.143 and -0.237 respectively. But, the association is found to be insignificant implying that, there is no significant relationship between working capital management practices and performance especially with CCC. Hence, null hypothesis is accepted and alternative hypothesis is rejected.

Key Findings

The current assets to total assets ratio shows a weak positive relationship with performance measure of ROA and ROE adopt by this study.

This indicates that Sri Lankan manufacturing companies follow conservative working capital management practices.

Conclusion

The study indicates that there is a negative relationship between working capital management practices and performance especially with Cash Conversion Cycle. The R² values indicate that the variables of working capital management practices have a very little impact on ROA and ROE.

This study suggests that the manufacturing companies manage their working capital management practices efficiently to achieve optimal performance. This can be obtained by improving internal control process, collecting receivables in line with agreed credit policies by delaying deferral payments to payables. All these will lead to shorten the CCC resulting in best practice in working capital management which will lead to an increase in performance of Sri Lankan manufacturing companies.

Keywords: Asset; Performance; Stock Exchange; Return; Return On Equity; Working Capital Management Practices

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