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An Assessment of Working Capital Management on the Financial Performance of Private Institutions in Rwanda. A Case of Intersect Security Company

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***Abstract*:-** *The study focused on the assessment of working capital on the financial performance in Private Institutions in Rwanda and Intersect Security Company was taken as a case study .The study had specific objectives that included, to identify the levels of working Capital Management within Private institutions in Rwanda, to find out working capital management practices of Private institutions and to find out the relationship between working capital management and the financial performance of Private institutions in Rwanda. The Findings revealed that inventory management in Intersect Security Company has very low knowledge of inventory management theories. Although some review stock and keep enough stock, most of the Intersect Security Company as units were found with poor inventory management practices such as purchasing stock upon demand, were not regularly replenishing their stock and were adversely facing stock outs. Accounts payable or creditors' management practices of Intersect Security Company. Over all, the practices are poor as portrayed in payment of interest on late payment of creditors, absence of proper records of their obligations to supplier, suppliers are not informed of the delays in payments and that the businesses keep a delay payment policy. This implies that businesses have not been able to manage their suppliers' obligation in an efficient way. The Significant positive perception on debtors management as most respondents agreed to collecting debts before due dates , maintaining regularly updating records of their debtors, securing their debts, having a smaller percentage of irrecoverable debts and ensured debts keep payment in time.*

Background of the Study

This study was guided by the theories of; Indeed, Deloof (2003) suggests that firms might have an optimal level of working capital that maximizes their value. The literature has demonstrated that there exist optimal levels of its individual components, such as accounts receivable (Emery 1984a; Nadiri 1969), inventories (Ouyang, Teng, Chuang, and Chuang 2005) and accounts payable (Nadiri 1969).

The relation between working capital and firm´s profitability might, therefore, be concave rather than linear and these opposing effects might be captured with a quadratic relationship. This paper analyzes the relationship between investment in working capital and profitability taking into account the possible non-linearity's of the working capital management-profitability relationship in order to test this risk and return trade-off between different working capital strategies.

Management of working capital can have a significant impact on both the risk (risk of loss of business and interruptions of production process) and profitability. Specifically, working capital management practices that tend to enhance the profitability tend to increase this risk, and conversely those practices that reduce the risk tend to decrease the expected performance. On the one hand, since an additional investment in inventories or accounts receivable is usually associated with greater sales, a positive relation between working capital and profitability might be expected. Larger inventories can prevent interruptions in the production process and loss of business due to scarcity of products, and they can reduce supply costs and price fluctuations (Blinder and Maccini 1991). In addition, they allow firms better service for their customers and avoid high production costs arising from high fluctuations in production (Schiff and Lieber 1974).

The government of Rwanda like other developing countries has put a lot of efforts in supporting Private Institutions to grow as they have great potential to complement large industries through business linkages, partnerships and subcontracting relationships. However, despite the support and their important role for growth and employment, the failure rate of small business initiatives in Rwanda is phenomenal and the lower levels of performance is attributed to the low levels of managerial skills and competencies particularly in the areas of working Capital Management and financial management.

1.2 Statement of the Problem

The government of Rwanda like other development countries has put a lot of efforts in supporting Private institutions to achieve its goals as they contribute to the economic development of the country.

For small and growing businesses, an efficient working capital management is a vital component of success and survival; i.e. both profitability and liquidity (Peel and Wilson, 1996). According to Wilson (1996), smaller companies should embrace formal working capital management practices with the hope of minimizing the probability of business failure, as well as to enhance business performance.

The lower levels of financial performance is attributed to the low levels of skills and competencies particularly in the areas of working capital management, and as a result, the research sets out to assess the impact of working capital management on the financial performance of Private institutions in Rwanda to overcome their failure rates.

1.3 Purpose of the Study

The purpose of this study is to assess the working capital management on the financial performance for Intersect Security Company as one of the Private institution in Rwanda.

1.4 Objectives of the Study

The objectives of this study are:

I. To identify the levels of working Capital Management within Private institutions in Rwanda

II. To find out working capital management practices of Private institutions

III. To find out the relationship between working capital management and the financial performance of Private institutions in Rwanda.

1.5 Research Questions

The study was to answer the following questions:

I. What are the levels of working Capital Management within Private institutions in Rwanda?

II. What are working capital management practices of Private institutions in Rwanda?

III. What is the relationship between of working capital management and the financial performance of Private institutions in Rwanda?

LITERATURE REVIEW

Working capital management

Harris (2005) as cited by (Berman, 2006) defines working capital management as the decision relating to working capital and short term financing, and this includes managing the relationship between the company's short-term assets and its short-term liabilities.

Stock management

Stock also called inventories are the products a company is manufacturing for sale and components that make up the product. It also includes product that a company purchases for sale (Poutziouris, et al., 1998). According to Horne (1985) accompany should maintain adequate materials for a continuous supply but he also argues that maintaining inventories involves tying up of the company's funds and incurrence of storage and handling costs.

Receivables management (Debtors management)

A debt is created when a firm sells its products or services for which payment is expected to be collected in the near future. (Pandey, 1995). According to Campsey (1985) accounts receivable is a balance due from a customer.

Creditor's management

Bringham (1985) explained that creditors or trade credit is an inter-firm arising from credit sales, recorded as an accounts receivable by the seller and as an accounts receivable by the buyer, forming a larger percentage of the current liabilities for smaller firms than bigger firms because small companies do not qualify for financing from other sources, they rely rather heavily on trade credit.

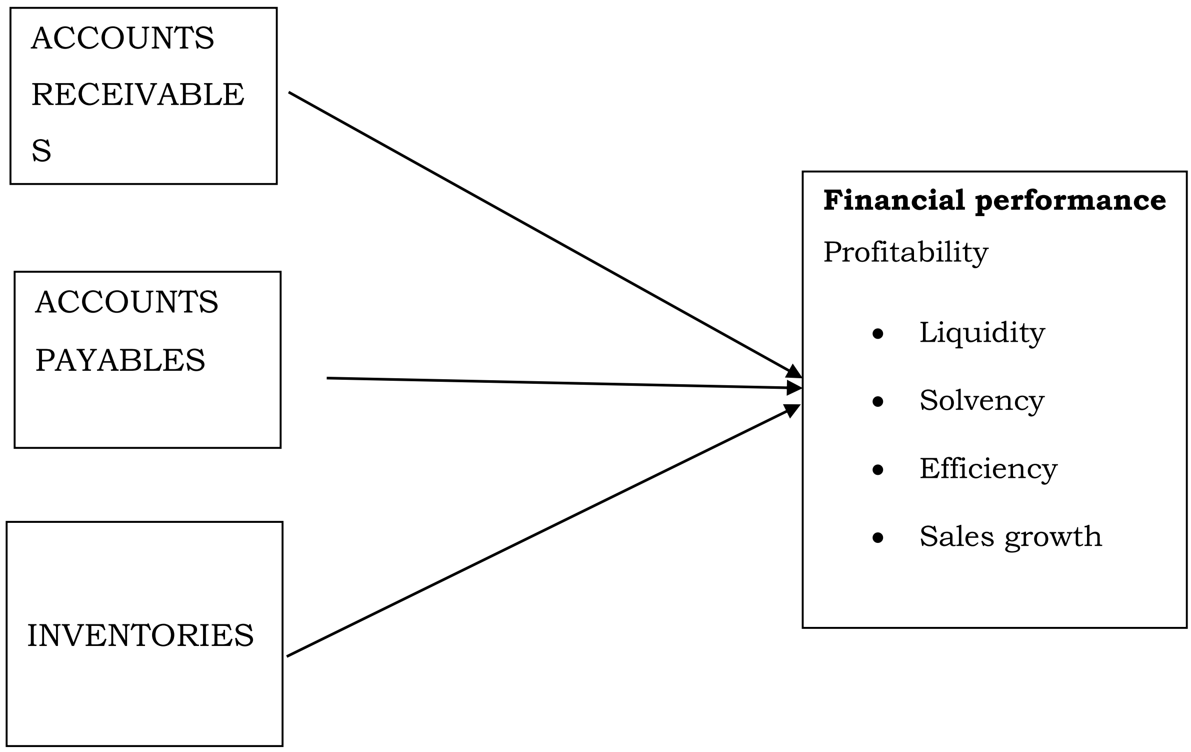
Financial performance

According to (O'mara, 1999), performance is taken to be the function of an organizational ability to meet its objectives by exploiting the available resources in an effective and efficient way. (Kloot,1999) adds that, performance entails effectiveness which refers to firm's ability to serve and produce what the market requires at a particular time and efficiency which means meeting objectives at the lowest possible cost with the highest benefits.

Profitability

Lisa (1999) asserts that within the micro enterprises literature, profits and profitability have been defined through various measures. In Serra (1996), for examples, defines net income as the sales receipts from goods or services minus variable and fixed costs.

1. Conceptual Framework



Source: Self developed from the works of Deloof (2003), Dobbins and Barnard (2000)

The model depicted above explains the relationship between the study variables.

From the diagram above, it is conceptualized that working capital management affect the financial performance of Private Institutions in Rwanda. Other factors affecting the financial performance of Private Institutions in Rwanda are held constant.

Working capital management for Private Institutions was measured in terms accounts receivables management, accounts payables management and inventory management (Deloof, 2003). Financial performance for Private Institutions was measured in terms of profitability, liquidity, solvency and sales growth (Dobbins and Barnard, 2000)

Research Gap Identification

Various empirical studies investigated showed different variables of study as well as different results. For instance study of Narasimhan and Murty, 2001, stress on the need for many industries to improve their return on capital employed (ROCE) by focusing on some critical areas such as cost containment, reducing investment in working capital and improving working capital efficiency.. Further Kakuru (1998) argued that cash collections should be speeded up while cash disbursements are tightly controlled. (Wilson, 1996) reports a strong relationship between efficiencies in managing the cash cycle and profitability. All these research revealed different interest for different researchers in different parts of the world. However, not much literature was found to concentrate on the two variables. In addition, the current research offer more empirical evidence as it divert from previous studies by focusing on how Working capital management lead to financial performance. Hence, this research identified a research gap in this area which it attempts to fill through the empirical research.

3. Research Methodology

Research design

According to Church Hill (1992:108), a research design is a framework or a plan for the study used as a guide in collecting and analyzing data. It is a blue print that is followed in completing a study. In the present study, the researcher used across sectional approach where data for the same period related to the variables under study was considered.

Study Population and Sampling

There are 540 employees working in Intersect Security Company, 20 managers and 41 employees are working in Finance and Administration department. Therefore, 61 employees were considered as the sample size for this study.

Accessible Population

The Accessible population includes the managers and accountants since they are the ones knowledgeable about the present research variables.

Sample size

The Sample of 61 respondents working in Finance and Administration department selected from 540 employees working in the company as well as clients of the company. The 61 respondents were distributed among the managers, accountants and clients of the company since they are the ones knowledgeable about the present research variables (working capital management and financial performance).

Sample Selection Procedure

The researcher used stratified and purposive sampling where the population was divided into strata for interviews and purposive sampling techniques was required to get data from the employees whose knowledge about the issue is useful.

Data collection Process

Questionnaire was designed and administered to respondents from the Intersect security company and Company's clients. Interviews were also conducted to the respective respondents.

Documentation was also used by reviewing annual financial statements of the respective years in the scope of the study to be Intersect Security Company as.

Primary data

Primary data was collected from the respondents using self-administered questionnaire. The variables on which primary data was collected include working capital management and financial performance of Intersect Security Company. The variables were measured by a combination of different questions and secondary data.

Secondary data

Secondary data was collected from permanent files such as annual financial statements of the unit of analysis, policy documents and desktop results both published and unpublished documents relating to the present study.

Ethical Consideration

Ethical issues under this present research were methodical to Pertain confidentiality of data to be collected from both primary and secondary sources, the consent of respondents and researcher's responsibility.

Data entry and analysis

Data collected was edited first, coded, classified and entered into a computer for analysis. The processing of data enabled the researcher to check for completeness and accuracy of private institutions as well as to establish existence and nature of relationship between Working capital management and financial performance.

The SPSS program was used for data analysis. Correlation and regression tests shall be used to establish existence and nature of relationship between Working capital management and financial performance.

4. Summary of the findings in relation with the objectives of the study.

Findings reveal that inventory management above show that In Intersect Security Company has very low knowledge of inventory management theories. Although some review stock and keep enough stock, most of the Intersect Security Company as units were found with poor inventory management practices such as purchasing stock upon demand, were not regularly replenishing their stock and were adversely facing stock outs. This is an indicator of poor inventory management practices and contradicts with the works of Pike (1998) who argues that, the secret of good stock management is knowing what stock to buy, when to buy it, how often , and at what quantities to meet customer's demand. Good inventory management practices was take the form of maintaining adequate stock of equipment's and other materials for a continuous supply and use in service. This is supported by the views of Brook son, (1998) who argued that insufficient stock can result in lost sales, delays for customers etc. and hence the key is to know how quickly your overall stock is moving or, put another way, how long each item of stock sit on shelves before being sold.

Results also disclose accounts payable or creditors' management practices of Intersect Security Company. Over all, the practices are poor as portrayed in payment of interest on late payment of creditors, absence of proper records of their obligations to supplier, suppliers are not informed of the delays in payments and that the businesses keep a delay payment policy. This implies that businesses have not been able to manage their suppliers' obligation in an efficient way. This concurs with what Singleton and Wilson (1998) who state the natural reaction of small businesses suffering from late payments from their customers is to delay payments to their suppliers. However, paying bills late is the most expensive form of business finances (singleton and Wilson, 1998). This also agrees with Jarvis et al (1996) who argue that creditors are a vital part of effective cash management and could be managed carefully to enhance the cash position. Purchasing initiate's cash and outflows and an overzealous purchasing function can create liquidity problems. Management of creditors is as important as management of debtors a good supplier is someone who was work with you to enhance the future viability and profitability of your company (pike et al, 1998)

Findings also disclose the Significant positive perception on debtors management as most respondents agreed to collecting debts before due dates , maintaining regularly updating records of their debtors, securing their debts, having a smaller percentage of irrecoverable debts and ensured debts keep payment in time. This is in line with gamble (2004) who argues that every business needs to know who owes money to them, how much is owed, how long is it owing, for what is owed. Slow payment has a crippling effect on business; in particular on small business who can least afford it. If you don't manage debtors, they was to manage your business as you was gradually lose control due to reduced cash flow and of course, you could experience an increased incidence of bad debts. It is also in agreement with

Horne (1998) who says a firm's credit policy is a major influence on the level of its investment in accounts receivables and Soufani (2002) who argues that investment in accounts receivables was high if customers are allowed extended time period for making payment

The study revealed a positive relationship between proper management of working capital and financial performance. The relationship is linear and significant which is in conformity with Peel and Wilson (1998) who stressed that the efficient management of working capital and more recently good credit management practice as being pivotal to the health and performance of the small firm sector. The again concurs with the findings of shin and Soenen (1998) and the more recent study of Deloof (2003) who have found a strong significant relationship between the measures of working capital management and profitability as a measure of financial performance. The findings suggest that managers can increase profitability and performance by reducing the number of day's accounts receivable and inventories. This is particularly important for small growing firms who need to finance increasing amounts of debtors

Brook son, (1998) supports the findings by arguing that generally poor debtor management erodes profits and can lead to bad debts, which results into poor financial performance of a firm likewise if there is a large investment in stock which leads to typing up of a company's funds causing liquidity problems and possible loss of profits.

The research further indicates a significant positive relationship between working capital management and financial performance ($r = .510^{**}$; $p< 0.01$). This implies that working capital management influences improvement in working capital management improves financial performance and vice versa.

Conclusion

In general, the study looked at working capital management and financial performance of Private Institutions in Rwanda, a case study of Intersect Security Company.

The study found out that working capital management was low in Intersect Security Company and was to be improved if businesses were to grow and perform efficiently. This is supported by the findings of Wilson (1998) who stressed that the efficient management of working capital and more recently good credit management practice as being pivotal to the health and performance of the small firm sector. The again concurs with the findings of shin and Soenen (1998) and the more recent study of Deloof (2003) who have found a strong significant relationship between the measures of working capital management and cm and profitability as a measure of financial

Overall, the findings revealed a significant positive relationship between the study variables. Working capital management had an influence in determining the level of financial performance of the private Institutions in Rwanda. It is therefore important to note that for the private Institutions to perform well there is need to seek for the combined efforts for better competent managers in general management functions and particularly working capital management as these are seen to have an impact on the financial performance of private Institutions.

Recommendations

- In order to increase firm's performance and to benefit from staff capabilities, it is recommended that practitioners and private Institution's managers increase the involvement of the staff in the process of strategic management of their firms
- A more stringent management of inventory should be adopted and inventory managers should have enough training in stock control. Store managers should be trained in good inventory management models that help improve on stock management of the firm
- There is also a need to develop a strong creditor management policy and system that was enable the Private Institutions to improve supplier relationships. Some of the policy should include but not limited to maintaining strong liquidity position to meet the obligations as they become due, matching maturities of debt recoveries and creditors' payments.

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