Working capital management and profitability in an era of pandemic: Evidence from micro, small and medium enterprises

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Abstract
The study examined the nexus between working capital management and profitability in an era of pandemic among Micro, Small and Medium Enterprises (MSMEs). The study adopted a survey research design while Primary data was obtained from listed members of the Kwara State Chamber of Commerce, Industry, Mines and Agriculture (KWACCIMA) within Ilorin metropolis of Kwara State. Convenience sampling technique was used in the administration of structured questionnaires to 81 MSMEs owners who were considered in the sample size to obtain the data analyzed. Pearson Product Moment Correlation (PPMC) was used to analyze the data obtained. The findings of the study revealed that majority of the MSMEs in Ilorin metropolis had sufficient awareness of working capital management while a negative relationship was also found between working capital management practices and profitability with r(79)=0.462=-0.025 with working capital management explaining 21% of the variation in profitability. The study concluded that there is high knowledge of the concept of working capital management among MSME business owners in Ilorin metropolis and an inverse relationship exist between working capital management and their profitability. The study recommended that more awareness of working capital management components such as Debt Management (DM) and Cash Conversion Cycle (CCC) still needs to be sought to improve their profitability especially to curtail financial disruptions during the era of pandemic.

Keywords: Nigeria, MSMEs, Pandemic, Profitability, Working Capital

1.0 Introduction

It is generally believed that some amount of fund is needed to start a particular business but the awereness and management of such fund which is refered to as working capital need to be known.Thus, management of working capital is one of the critical part of the financial management of many organisations. It deals with the choice of the composition of current assets and current liabilities in a business (Mansoori & Muhammad, 2012). Working capital administration assumes an imperative part in the growth of shareholder's wealth of firms.

Dealing with working capital (WC) involves managing relationships between a firm's short-term assets and liabilities to ensure that a firm is able to continue its operations, and have sufficient cash flow to satisfy both maturing short-term debts and upcoming operational expenses at minimal costs, and consequently, increasing corporate profitability. WC refers to the firm's current assets and current liabilities required to be combined with fixed assets for the day-to-day business activities (Barine, 2012). The current assets necessary for the working of fixed assets are accounts receivable, inventories and cash, while the current liabilities necessary for the working of fixed assets are accounts payable. These current assets and current liabilities constitute the components of WC.

Management of WC is an important component of corporate financial management because it directly affects the profitability and liquidity of firms (Angahar and Alematu, (2014). According to Ani, Okwo and Ugwunta (2012), working capital refers to the inventory with the ability to be converted or resale so as to make profit.

Previous researchers in the area of working capital management and MSMEs profitability have come out with mixed findings, though the context in terms of nature of businesses and location of research differs. For example, Gama (2015), Banos-Caballero, and Garcia and Martinez, (2010) reported that working capital management has a positive link with MSMEs profitability in Portuguese and Spain respectively. So also, Tauringana and Afrifa (2013) found a significant positive effect of the components of working capital management on MSMEs ' profitability in the United Kingdom. Similarly, Afeef (2011), Lyngstadaas and Berg (2016) and Tran, Abbott and Jin-Yap (2017) found a similar result in Pakistan, Norway and Vietnam respectively.

On the contrary, Caballero, Garcia and Pedro (2012) found a negative relationship between working capital management profitability of Spanish MSMEs in a different study. In a similar development, Gul, Raheman, and Khan. (2013) reported a negative relationship between working capital management and performance of MSMEs in Pakistan. So also, Konak and Güner (2016) and Napompech (2012) found a similar result in Spain, Istanbul, and Thailand respectively. The inconsistencies in the findings make the research on working capital management and profitability of MSMEs inconclusive. Therefore, this paper examines the working capital management and profitability in an era of pandemic: an evidence of Micro, Small and Medium Enterprises (MSMEs) in Ilorin metropolis as previous empirical research has focused largely on larger organisations and for MSMEs in other countries.

Experiences and personal interactions of the researchers show that larger percentage of MSMEs in Ilorin metropolis have no awareness of the working capital management which is a big impediment in the sustainability of their business.

In view of the above aforementioned problems confronting MSMEs in Ilorin metropolis alongside the efforts that the government has put in place in ensuring MSMEs growth and sustainability, this paper intends to examine the level of awareness of working capital management on profitability of MSMEs in Ilorin metropolis with a view to recommend meaningful solutions for poor working capital management confronting some of the owners of MSMEs.

Research Questions

The following research questions were raised to guide the study:

i. What is the level of awareness of business owners on working capital management in Ilorin metropolis?
ii. What is the relationship between working capital management and profitability of MSMEs in Ilorin metropolis during an era of pandemic?

Objectives of the Study

The main objective of this research work is to examine the nexus of working capital management and profitability of MSMEs in Ilorin metropolis. However, the specific objectives are to:

i. Evaluate the level of awareness of business owners on working capital management in Ilorin metropolis.
ii. Determine the relationship between working capital management and profitability of MSMEs in Ilorin metropolis during an era of pandemic.

2. Literature Review

Working Capital is the capital of a business which is used in its day-to-day trading operations, calculated as the current assets minus the current liabilities (Bhojawala, 2019). Working capital, also known as net working capital (NWC), is the difference between a company's current assets, such as cash, accounts receivable (customers' unpaid bills) and inventories of raw materials and finished goods, and its current liabilities, such as accounts payable (Ingule, 2020).

Working capital is a measure of a company's liquidity, operational
efficiency and its short-term financial health. If a company has substantial positive working capital, then it should have the potential to invest and grow. If a company's current assets do not exceed its current liabilities, then it may have trouble growing or paying back creditors, or even go bankrupt, (Ingule 2020). Working capital is a measure of a company's liquidity, operational
efficiency and its short-term financial health. If a company has substantial positive working capital, then it should have the potential to invest and grow. If a company's current assets do not exceed its current liabilities, then it may have trouble growing or paying back creditors, or even go bankrupt, (Ningule, 2020).

It should also be noted that a company has negative working capital if the ratio of current assets to liabilities is less than one; Positive working capital indicates that a company can fund its current operations and invest in future activities and growth; High working capital isn't always a good thing. It might indicate that the business has too much inventory or is not investing its excess cash.

In the words of Walter (2014), Working Capital means the amount by which total current assets exceed current liabilities and is affected by current assets such as cash, stock, bank balance and prepayments as well as current liabilities that include creditors and accruals. There is no doubt that the working capital attracts so many benefits to the SMSEs. This is because, the higher the working capital, the more the liquidity of the firm.

The components of working capital a firm invests in and its level of investments is a function of firm's operating factors. Investment in accounts receivable, is determined by the firm's credit policy. The longer the credit period given to a customer, the higher will be its investments in accounts receivables Brealey and Myers (2006). Brealey and Myers (2006) further pointed out that, to forestall adverse effects of credit on firm operators, working capital efficiency require constant updating of credit performance, and developing sound criteria for credit extension and that, with regard to accounts payable, the exceeding of normal credit terms deliberately, making interest pay off more favorable; cautioning of the risk of affecting the company's credit standing if delays beyond the credit terms granted, become habitual. Sound management of suppliers' credit, thus requires current up-to-date information on accounts and aging of payables to ensure proper payments.

Nwidobie (2012) averred that, working capital components are controllable by firm management. Empirical studies reveal that investments in firm's working capital have attendant costs and benefits. Firms reduce investments in inventories of raw materials to accumulate cash, with the risk of running out of inventories and production halt. Reduction in the amount tied up in receivables, by reducing credit to customers result in their patronizing the firm's competitors. Cost of firm's investments in receivables is the interest that would have been earned if customers had paid up quickly or interest paid on finance borrowed to acquire the current assets. The firm also forgoes interest of investing such in marketable securities.

The cost of holding inventory he further stated is the storage, insurance costs, and risks of spoilage, obsolescence and the opportunity of cost of capital. These costs encourage firms to hold current assets to a minimum. Carrying costs discourages large investments in inventories; and low level of inventories make it more likely that the firms will face shortage costs. Running out of inventory will result in production shut down. Holding a small finished goods inventory will result in inability of the firm fulfilling orders. Holding little cash will require the firm selling securities to meet up its cash, and incurring capital market trading costs. Minimization of accounts receivables, restrict credit sales and loss of customers. These according to Brealey et al., (2006) suggest the need for striking a balance between the cost and benefits of current assets; finding the level of current assets that minimizes the sum of carrying costs and shortage costs.

Findings by Lazaridis and Tryfonidis (2005) from their study of firms listed on the Athens Stock Exchange between 2001 and 2006, showed a statistically strong relationship between profitability and behavior in a working capital component: cash conversion cycle. Eljelly (2004) cited in Onwumere, Ibe and Ugbam (2012) observed from his study of 929 companies in Saudi Arabia that the size of working capital variables has significant effect on profitability at the industry level. From their study of 8,872 small to medium size enterprises in Spain from 1996-2002, Garcia- Teruel and Martnez-Solano (2007) concluded that reduction in inventories and shortening of cash conversion cycle improve corporate profitability. To Yunos, Nazaruddin, Ghapar, Ahmad and Zakaria, (2015) there exists a significant relationship between account collection period, inventory conversion period and average payment period; and profitability as evidenced from findings of his study of 30 firms listed on the Nairobi Stock Exchange from 1993-2008 countering an earlier conclusion by Kamath (1989) cited in Michael Nwidobie (2012) of the existence of a reverse relationship between cash conversion cycle and profitability.

Findings from the Turkish firms by Samiloglu and Demirgunes (2008) showed that accounts receivables period, inventory period and leverage significantly and negatively affect corporate profitability. Similar conclusions were drawn by Raheman and Nasr (2007) from their study of 94 firms listed on the Karachi Stock Exchange from 1999-2004. Hayajneh and Yassine (2011) concluded that firm size, sales growth and current ratio (working capital components) affect corporate profitability from their study of 53 Jordanian manufacturing firms listed on the Amman

Exchange from 2000-2006. Thus, the central importance of working capital to the operational efficiency requires firms to put much emphasis on adequate planning, co-ordination and control of its working capital to reduce associated costs and increase revenues.

Ademola and Kemisola (2014) also investigated the relationship between working capital management and profitability of manufacturing firms listed on the Nigerian Stock Exchange. The study used secondary data of 120 firm-year observations of ten years (2002 and 2011). Survey research design was adopted. The data were analyzed using descriptive statistics, correlation analysis and multiple regression analysis. The dependent variable is net operating profit while the independent variable is the working capital management proxies by ACP, ICP and APP. The study indicated a positive and significant association between Working Capital management and Net Operating Profit. Inventory conversion Period showed insignificant negative relationship with Net operating profit of food and beverages manufacturing companies in Nigeria.

Makori and Jagongo (2013) used a sample of five manufacturing and construction firms and analyzed the effect of working capital management on firm's profitability in Kenya for the period 2003 to 2012. They used balanced panel data from annual account of the listed firms on the Nairobi Stock Exchange (NSE). Pearson correlation and Ordinary Least Squares regression techniques

profitability. Among other findings, the study documents a positive relationship between profitability and number of days of inventory. The findings indicated that the management can increase the level of sales by increasing their inventories conversion period to a reasonable level. In doing so, the profitability of the firms were expected to increase.

It is observed from available literature the dearth of studies on working capital management and profitability of MSMEs in Kwara State, Nigeria especially during the COVID-19 pandemic, hence, the need for this study.

Traditionally, investors, creditors and bankers have considered working capital as a critical element to watch, as important as the financial position portrayed in the Statement of Financial Position and the profitability shown in the income statement. Working capital is a measure of the company's efficiency and short term financial health. It refers to that part of the firm's capital, which is required for financing short-term or current assets such a cash marketable securities, debtors and inventories. It is a firm's surplus of current assets over current liabilities, which measures the extent to which it can finance any increase in turnover from other fund sources. Funds thus, invested in current assets keep revolving and are constantly converted into cash and this cash flow is again used in exchange for other current assets. That is why working capital is also known as revolving or circulating capital or short-term capital. ***Formula for Working Capital: "Current Assets – Current Liabilities"***

Profitability on the other hand is the ability of a business to earn a profit. 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, (Taylor &Ömer, 2020).

Profitability is a measurement of efficiency – and ultimately its success or failure. A further definition of profitability is a business's ability to produce a return on an investment based on its resources in comparison with an alternative investment (Langenwalter, 2020). Profitability is the primary goal of all business ventures, (Werhane, Newton & Wolfe 2020).

MSMEs put in place various working capital management measures in order to ensure efficient working capital management and organizational profitability. These measures are the independent variables since they determine the efficiency of working capital management and ultimately, the profitability of the organization. The conceptual framework is shown in Figure 1 below:

Independent Variable Dependent Variable

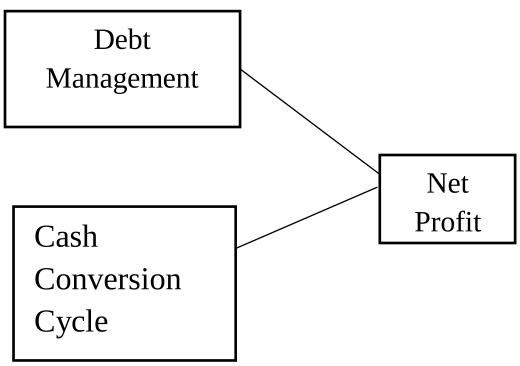

Figure 1: Study Model

Source: Adopted and Modified from Daniel and Amos (2014)

The study model shows that working capital management measures (independent variables) affects MSMEs' profitability (dependent variables). When working capital management measures are put in place, they affect the efficiency of working capital and therefore organizational profitability, which is normally reflected by higher return on assets and return on investment/equity ratios.

The Risk –Trade off Theory (Myers 1984)

Working capital decisions provide a classic example of the risk-return nature of financial decision making. Increasing a firm's net working capital, current assets less current liabilities, reduces the risk of a firm not being able to pay its bills on time. This at the same time reduces the overall profitability of the firm. Working capital management involves the risk-return trade-off: not taking additional risk unless compensated with additional returns Nwidobie (2012). This theory is in line with the independent variables since lack of meeting financial obligation on the part of firms threaten their relationship with creditor and paying off all creditors which will affect the cash position negatively as it tends to reduce profit. Therefore, managers have to strike a balance between these two positions as implied by Nwidobie (2012).

Adamu, Onwe and Caroline (2008) averred that, all the decisions of the financial manager are assumed to be geared towards the maximization of shareholders wealth, and working capital decisions are no exception. Accordingly, they stated, risk return tradeoff characterizes each of the working capital decision and that, there are two types of risks inherent in working capital management (WMC), namely: liquidity risk and risk of opportunity loss. Liquidity risk is the non-availability of cash to pay a liability that fall due. It may happen only on certain days. Even so they averred, it can cause not only a loss of reputation but also make the work condition unfavorable for getting the best terms on transaction with the trade creditors.

Deloof (2003) in Malik, Waseem, and Kifayat, (2012) averred that, working capital management is an important factor of financial management. Firms may have optimal level of inventory. Large inventory and free trade credit policy as he observed, make it possible to increase sales volume. Moreover, large inventory stock reduces the risk of a stock out. Findings of this study show that firms having a large amount of cash invested in working capital also have extensive amounts of short-term payables as a source of financing. Moreover, delaying payments to suppliers allows a firm to evaluate the superiority of the products bought, and can be an economical and elastic source of financing for the firm. In managing accounts payable, delaying payments to suppliers can be used for flexible and inexpensive source of financing a firm, but late payments can also be very costly if the firm is offered discount for early payment.

There exist many theories about trade credit, and many researchers have been made to show if theories are right. For example, Lakshan (2009) found that firms use trade credit more when credit from financial institutions is not available. Investments in customer credit in the form of accounts receivables and inventories of goods or materials are long-term resource commitments. Minimization of these investments relative to the level and pattern of a firm’s operation is crucial in the total management of operating funds. The key to a successful management of customers credit and inventories according to Nwidobie (2012) is a clear understanding of the economies of trade-offs involved in it. Credit terms are a function of the competitive environment as well as of a careful assessment of the nature and credit worthiness of the customers.

Involved in the above, Nwidobie (2012) averred, is the decision on whether extended credit terms, and the resulting rise in receivables outstanding are compensated for by the contribution from any incremental sales gained. Similarly, extending normal credit to marginal customers need to be carefully assessed in terms of risk of delayed payments or default, compared with contribution from sales gained. To forestall adverse effects of credit on firm operators, working capital efficiency require constant updating of credit performance, and developing sound criteria for credit extension. Efficiency in credit management ensures that a firm is able to pay its bills on time and carry sufficient stocks McMenamm (1999) cited in Nwidobie (2012). The other risk involved in WCM Adamu, Onwe and Caroline (2008) pointed out, is the risk of opportunity loss, that is, the risk of having two little inventories to maintain production and sales or the risk of not granting adequate credit for realizing the achievable level of sales. In other words, it is the risk of not being able to produce more or sell more or both and, therefore, not being able to earn the potential profit, because there were not enough funds to support higher inventory and book debts.

Nwidobie (2012) stated that, Investment in inventory is a function of the cost of holding such inventory, storage, obsolescence, opportunity cost of investments in inventory, rate of return on other equivalent-risk investment opportunities. He further observed that the higher the cost of holding inventory, the lower will be the level of inventory a firm will hold and that, discounts on bulk purchases also determine the amount of inventory held in a firm. Benefits of holding inventory are reduction in stock-outs for production and sales with its attendant costs.

3. Methodology

The study adopted descriptive research design as it enables the researcher to analyse the relationships among a large number of variables. The choice of this method is also informed by the fact that MSMEs are scattered in different locations. The use of descriptive research design in working capital management research areas has been supported by the past empirical literature (Deloof, 2003 and Raheman & Nasr, 2007). The study was carried out in Kwara State where convenience sampling technique was used in the administration of structured questionnaires to MSMEs owners who were considered in the sample size to obtain the data analyzed. The study adopted both the descriptive and inferential analyses. Frequency table was used for description of the survey result while Pearson Product Moment Correlation (PPMC) technique was used for inferential analysis.

4. Results and Discussion

Test of Hypotheses

Hypothesis I: The level of awareness of working capital by MSMEs in Ilorin metropolis is insignificant

Table 1: *Working Capital Awareness*

	Frequency	Percent
YES	77	95
NO	4	5
Total	81	100

Source: Authors field work, 2020

Table 1, reveals that out of the 81 business owners in Ilorin metropolis that responded to the administered questionnaire 77 respondents (95%) agreed that the have working capital awareness while only 4 respondents (5%) agreed they had little or no knowledge about working capital. The results from the survey, therefore, suggest that the level of awareness of MSME owners in Ilorin metropolis is high and thus significant.

Hypothesis II: There is no relationship between working capital management practice and profitability of MSMEs in a pandemic

Table 2: *Pearson Product Moment Correlation Coefficient on Working Capital Management practices and Profitability.*

Variable	N	Mean	SD	df.	*r*	p-value	Decision
WC	81	1.0494	.21802	79	0.462	-0.025	Significant
PT	81	1.0123	.11111	79			

Source: Authors field survey, 2020

The was statistically significant, moderate relationship between working capital management practices and profitability $r(79)=0.462=-0.025$ with working capital management explaining 21% of the variation in profitability. This shows that an increase in working capital management will lead to a low in the profitability.

The findings of the study revealed that:

i. The level of awareness of Micro Small and Medium Enterprises (MSMEs) owners in Ilorin metropolis is high and thus significant as 95% of the respondents revealed that they were aware of the concept of working capital.

ii. There is a significant negative relationship between working capital management practices and profitability. This implies that as working capital management practices increase, it will have negative significant influence on the profitability with 2.5% negative significant relationship. This is tandem with the findings of Caballero etal (2012), Gul etal (2013) and Napompesh (2012) who also found similar results of negative relationship between working capital management and performance of MSMEs in Spain, Pakistan, Istanbul, and Thailand respectively.

5. Conclusion

The study concluded that most MSME business owners in Ilorin metropolis are highly knowledgeable of the concept of working capital management and there is a negative relationship between working capital management and profitability of MSMEs during era of pandemic.

6. Recommendations

The study recommended that:

i. There is need for more awareness of working capital components such as what constitutes assets and liabilities, cash conversion cycle and debt management needs to be sought by business owners that owns MSMEs

ii. MSME owners should pay more attention on APP and DM as they are correlated to their profitability.

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