THE IMPACT OF WORKING CAPITAL MANAGEMENT PRACTICES ON PROFITABILITY OF ELECTRICAL SHOPS IN UGANDA

A CASE STUDY OF NGO POWER CENTER

BY:

NAMAWEJJE SWAFULAH

23/U/BSAF/1178/K/DAY

CHAPTER ONE

1.0 Introduction

This chapter presents background of the study, statement of the problem, purpose of the study objectives, research questions, hypothesis, scope of the study, significance of the study and operation definitions of key terms.

1.1 Background of the study.

Working capital management is a very important component of corporate finance because it directly affects the liquidity/risk, profitability and consequently the value of a firm and the shareholders wealth. There are two important elements of working capital management: decision on the amount of current assets to be held by the firm for efficient operations of its business and decision on financing working capital requirement. Inadequacy or mismanagement of working capital is the leading cause of many business failures.

Working capital management is essential for the long-term success of a business. No business can survive if it cannot meet its day to day obligations. A business must therefore have clear policies for the management of each component of working capital. Excessive levels of current assets can easily result in a firm's realizing a substandard return on investment. However firms with too few current assets may incur shortages and difficulties in maintaining smooth operations (Home and Wachowicz, 2000). Working capital has two concepts: gross working capital and Net working capital. Gross working capital refers to the firm's investment in current assets while net working capital refers to the difference between current assets and current liabilities (Pandey, 2005).

Investment in current assets should be just adequate to the needs of the enterprise. Working capital needs for a firm keeps fluctuating which causes shortage or excess of working capital. Therefore management of working capital should be able to correct such imbalances (Pandey, 2005). Similarly, whenever need for working capital increases due to the increasing level of business activity, arrangement for financing should be made quickly. If some surplus funds arise they should not be allowed to remain idle and should be invested in short-term securities (Pandey, 2005).

Profitability is the primary goal of all business ventures. Without profitability the business will not survive in the long run. So measuring current and past profitability and projecting future profitability is very important. Therefore working capital management should ensure a good tradeoff between risk and profitability. To have higher profitability, the firm may sacrifice solvency and maintain relatively low level of current assets. This increases profits because fewer funds are tied up as idle current assets but its solvency will be threatened and would be exposed to greater risk of cash shortage and stock-outs (Pandey, 2005).

The study therefore sought to explore the relationship of working capital and profitability in NGO power center.

1.2 Problem Statement

NGO power center,a leading wholesaler of electrical items faces significant challenges in managing its working capital and cash flows. The company's inefficient cash conversion cycle, high accounts receivable and inventory levels(valued at 30% of the stock), inadequate cash forecasting processes can result into: Insufficient liquidity to meet short-term obligations, Inadequate funding for business growth and expansion, Increase in borrowing costs due to high interest rates, Reduced profitability due to idle inventory . Failure to manage their receivables may lead to bad debts .It is against this background that the study sought to find whether there is a relationship between working capital management and profitability of business.

1.3 Objective of the study.

1.3.1 General objective of the study.

The main purpose is to assess the contribution of working capital management on profitability of NGO Power centre.

1.3.2 Objectives of the study.

i. To examine the contribution of working capital management on profitability of NGO power center.
ii. To determine the challenges faced by NGO power center in increasing its profits.
iii. To identify the various working capital in NGO Power center.

1.4 Research Questions

i. What are the contributions of working capital management on profitability in NGO power center.
ii. What are the challenges faced by NGO Power center in increasing it's profits.
iii. What are the various working capital management practices in NGO power center.

1.5 Hypothesis of the study

There will be positive effect of cash management on the profitability in NGO power center.

There is positive contribution of working capital management on profitability of NGO power center.

1.6 Scope of the study.

It contains the content scope,Geographical scope and time scope .

1.6.1 **Geographical scope**

The study shall be carried out on NGO power center,located in Nabweru division, Wakiso district in kilokole town off Gayaza Road near Ttula petrol station.

1.6.2 Content scope

The study shall concentrate on working capital management practices namely: cash management, inventory management, receivables management and trade credit management and how these practices affect profitability. Also, the study shall look at the trade-off between liquidity and profitability.

1.6.3 Theoretical scope

The researcher shall use the Van Home theory 1980 of aggressive/conservative approaches in Working capital management. Which states that in Aggressive Approach the company finances all of its fixed assets with long term capital but part of its permanent current assets with short-term credit while in conservative approach, permanent capital is being used to finance all permanent assets requirements and also to meet some or all of the seasonal demands(Van Home, 1980).

1.6.4 Time scope

The study shall look at the organization for two years that is to say from 2024 to 2026 to look at the working capital and profitability ratio of Ngo power center.

1.7 Significance of the study

The study shall depend on knowledge and understanding of the topic under study. It will add to the existing knowledge on working capital management that will be of use to the students, university communities and the public at large.

The study will benefit the finance managers of electrical shops on how to improve profitability by practicing good working capital management and also how to strike a balance of liquidity and profitability using optimal working capital management practices.

The study will benefit the business owners on how to make the best of working capital management so as to reap benefits of liquidity and profitability trade-off.

The study will benefit those people who want to start their enterprises in knowing what to expect in terms of working capital management practices and profitability of their enterprises.

1.8 Justification of the study.

Effective working capital and cash management are crucial for any business to ensure financial stability, sustainability and growth thus the study shall improve on the working capital and cash management of Ngo power center.

1.9 Operational definitions of key terms

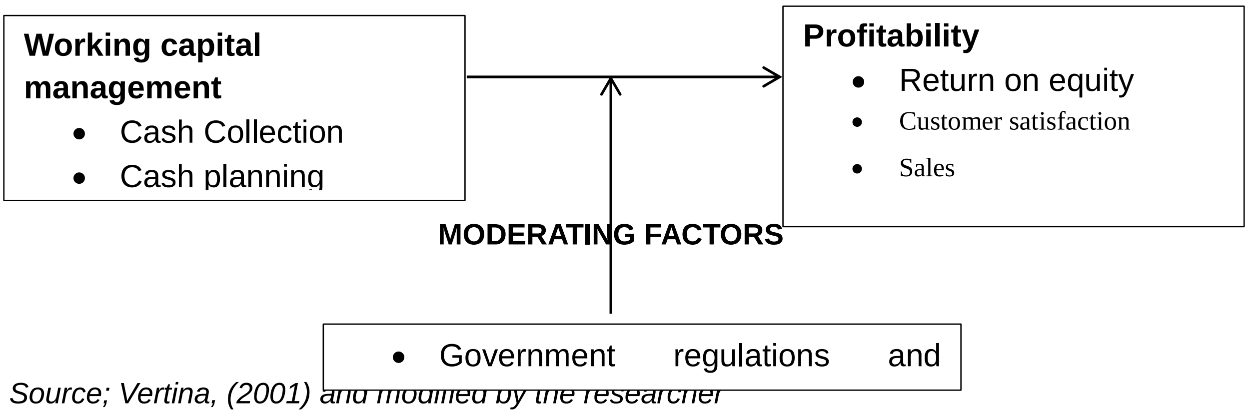
1. Cash management refers to the collection, concentration, and disbursement of cash.
2. Inventory management is the process of efficiently overseeing the constant flow of units into and out of an existing inventory. This process usually involves controlling the transfer in units in order to prevent the inventory from becoming too high, or dwindling to levels that could put the operation of the company into jeopardy.
3. Gross Working capital refers to a firm's investment in current assets
4. Net working capital' refers to difference between current assets and current liabilities
5. Liquidity is the ability of a firm to meet short-term obligations as they fall due
6. Profitability is excess of sales over costs. It is the measure of how much profit a company is generating relative to its expenses and costs.

1.10 Conceptual Framework

Conceptual framework is referred to as a network, or "plane" of interlinked concepts that together provide a comprehensive understanding of a phenomenon (Yosef Jabareen, 2009).

Figure 1.1 showing the relationship between cash management and Financial Performance

Independent variable **Dependent variable**



Source; Vertina, (2001) and modified by the researcher

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter shows what other scholars have written about working capital management practices and profitability. This section shows all the literature that will be used in the study, the section first presents the related studies according to objectives and related studies on the independent and dependent variables.

2.1 Working Capital Management

Working capital management is concerned with the problems that arise while managing current assets, current liabilities, and inter-relationship that exists between them .There are two concepts of working capital: Gross working capital which is equal to the total investment in current assets; and Net working capital which is the difference between current assets and current liabilities. It can be described as that part of a firm's current assets which is financed with the help of long-term funds. Both of these concepts have significance in working capital management. Gross working capital helps in analyzing ways to optimize investment in current assets and methods for financing current assets. Net working capital indicates the liquidity position of the firm and the extent to which the working capital needs should be financed by long-term sources of funds.

Working capital management determines the level of working capital to be maintained. According to Rao (2009), The exact amount of working capital that should be maintained varies from firm to firm and depends on various factors like nature of business, degree of competition, seasonality of operations, production cycle production policy, credit policy, market conditions, conditions of supply, size of the business, Age, growth opportunity and leverage.

2.2 Cash Management and Profitability

Mansueto (2009), states that cash is the lifeblood of a business and managing it efficiently is essential for success. Cash management involves; managing cash flows into and out of the business, Managing cash flows within the business and financing deficit or investing surplus cash and thus controlling cash balance .

According to Pandey (2005), Cash conversion cycle is the cash measure for working capital. It is the time between collections from sale of the product and cash payment for the resources acquired by the firm. It also represents the time interval over which additional funds should be obtained in order to carry out the business operations. It is calculated as inventory conversion period plus debtors'

2.3 Accounts receivables management and profitability

This is money due from all customers for merchandise or services delivered on credit. Management of this amount, shown as an asset on your company's balance sheet, can make or break your company. Methods for managing accounts receivable differ as widely as business types; however, processes should achieve three objectives: create a daily record of sales and receipts; generate invoices and statements on a recurring basis; and Track current and overdue balances on customer accounts.

According to Charlie (2009), to be able to effectively manage debtors one needs to have some policies in place like: Credit policies: Establish a credit policy and stick to it. Define the conditions under which you will extend credit. Billing policies:

2.4. Inventory Management and profitability

Inventory management is the process of efficiently overseeing the constant flow of units into and out of an existing inventory. This process usually involves controlling the transfer in of units in order to prevent the inventory from becoming too high, or dwindling to levels that could put the operations of the company into jeopardy.

Competent inventory management also seeks to control the costs associated with the inventory, both from the perspective of the total value of the goods included and the tax burden generated by the cumulative value of the inventory.

According to Pandey (2005), inventories constitute the most significant part of current assets of a large majority of enterprises. Because of the large size of inventories maintained by enterprises, considerable amount of funds is required to be committed to them. It is therefore imperative to manage inventories efficiently and effectively .

2.5. Accounts payable management and profitability

Creditor management is about maximizing the period from purchasing goods and services to paying for them, thereby reducing the working capital requirement in the business. This objective of maximizing the credit period must be carefully managed to ensure relationships with suppliers are not damaged and stock levels are optimized.

According to Morris (2009), all businesses should set a clear policy on creditor management that will under line their approach to sourcing and negotiating terms and conditions. That policy should take account of optimal stock holding levels (including the importance of holding buffer stocks to avoid stock outs) and timing of other cash flows within the business. The purchasing strategy should aligned to business goals and priorities should be set. Firm’s ability to optimize the credit period will be driven by a range of factors, including the relative importance and dependence of the business on particular suppliers and their dependence on the business .

CHAPTER THREE
RESEARCH METHODOLOGY

3.0 Introduction

This chapter entails the description of how the research is to be carried out. It represents research design, area of study, study population, sampling procedures, sample size, sampling techniques, data sources, data collection methods and instruments, quality control, validity, reliability, measurement of variables, data analysis, ethical considerations and limitations of the study

3.1 Research Design

The researcher shall use a sample design; specifically descriptive comparative and descriptive correlation. Descriptive in that the data to be collected shall be used to describe a phenomena.

Correlation is interested in relating working capital management practices to firms' profitability; Comparative in that the research shall determine the level of working capital management practices and profitability and the study shall be both quantitative and qualitative in nature.

3.2 Area of study.

The research shall be carried out on Ngo power center ,located in Nabweru division, wakiso district, kilokole town off gayaza road near Ttula petrol station.

3.3 Research Population

Study population shall include the traders/business operators that are working within Ngo power center, the manager, the cashier and Shop attendants that are selling different products like bulbs, meter boxes, and safety equipments. and the total population shall constitute to fifty(50)people.

3.4 Sampling Procedures

3.4.1 Sample size

The sample size shall comprise of traders/business operators that are working within Ngo power center such as managers,cashiers and Shop attendants selling different products like submeters.

3.4.2 Sampling techniques

Sampling is the process of selecting a random subset of individual observation for the purposes of making projections based on statistical inferences Amin (2005).

The sample size shall be got using purposive sampling and stratified sampling. This is because the researcher needs to get respondents who are knowledgeable in the area of study and also those willing to give the information. The respondents have to be selected based on leadership level, responsibility level and those willingness to participate. This technique shall allow the researcher to have required information basing on the set objectives of the study according to Mugenda and Mugenda (2009).

3.5 Data Sources.

These are sources where data shall be collected from about the study topic.

3.5.1 Primary Source

Data shall be obtained from first hand information directly through administering questionnaires to the selected respondents.

3.5.2 Secondary Source

Data shall be collected from already existing literatures such as textbooks, journals, annual reports, internet, magazines and newspapers among others.

3.6 Data collection methods and instruments .

Data collection methods are ways how data shall be collected from the field. These include the following ;

3.6.1 Questionnaire

The researcher shall use the questionnaire as a method of data collection to the identified set of respondents. Questionnaire is useful because it is efficient use of time that is information can be collected from a large number of people and the questions can be easily analyzed, anonymity is possible and everyone gets the same questions that are standardized. The researcher shall use the questionnaire method because the method is cheap in the collection of data and also provides a wide range of data.

A formal list of questionnaire shall be used to collect data from all selected respondents to give them equal opportunity as well. The researcher shall prepare dispatched questionnaires to the respondents.

3.7 Quality Control methods .

The methods include the following ;

3.7.1 Validity & Reliability

According to Amin (2005), validity is the extent to which a concept, conclusion or measurement is well founded and corresponds accurately to real world. It is considered to be the degree to which the tool measures what it is supposed to measure. Validity of the research instruments shall be established using expert judgment from the supervisor.

3.7.2 Reliability

Reliability is dependability or trustworthiness and in the context of a measuring instrument, it is the degree to which the instrument consistently measures whatever is measuring (Amin, 2005). Reliability of the instruments will be ensured through discussing with the supervisor on the instruments intended to measure and asking them whether the instruments designed would capture the required data. According Sekaran (2003) asserts that it must be 0.6 and above, upon performing the test on effect of working capital management performance and profitability.

3.8 Measurement of variables

The variables will be measured by the researcher using a Likert-scale. A scale consists of a number of statements which express either favorable or unfavorable attitude towards the given object to which the respondents are asked to respond. Each response is given a numerical score, indicating its favorableness or un favorableness and the scores shall be totalled to measure the respondents' attitudes. The scale of 1-5 shall be used to help the researcher measure the extent to which research objectives are to be achieved where 1 =strong agreement, 2= Agree with the statement, 3= undecided, 4= Disagree and 5= strongly disagree. The scale shall be used because its important in establishing numerical strength of study variables and understanding the perception of respondents

3.9 Data presentation and analysis

The researcher will collect data, process, and analyse the accuracy, consistency, proper arrangement and completeness of information. Hence the information obtained shall be used to verify the objectives under the study. The analysis of data is a process of inspecting, cleaning, transforming, and modelling data with the goal of discovering useful information suggesting conclusions and supporting decision making (Saunders, 2012). The analysis of data shall be done with the help of MS excel, the variables under study and the result were presented in tables for easy interpretation. Analysis shall be carried out by use of frequencies and percentage. The data shall be presented in tabular form, with frequencies and percentages for classifications of responses, easier analysis and visual impression.

3.10 Ethical considerations

i. To ensure confidentiality, the respondents shall be asked to sign consent forms, all questionnaires are to be coded for anonymity, Authors quoted in the study are to be recognized through citation and referencing, and the presentation of the findings are to be generalized.
ii. The researcher shall attain an introductory letter from the university to be used for accessing different targeted respondents.
iii. The researcher shall also inform consent of the respondents on the arrival at the data collection sites.

3.11 Limitations of the study

1. Financial constraints in carrying out research. The researcher shall require a lot of funds like transport and general welfare.
2. The researcher might face non-response of some questions especially where the respondents selected had little knowledge about particular questions.
3. The researcher might also experience time constraints in data collection due to the delay of respondents, analysing of data and in the final presentation of the report might take a lot of time

REFERENCES

Abdul Raheman and Mohamed Nasr (2007), Working Capital Management and Profitability—Case of Pakistani Firms, International Review of Business Research Papers, Vol.3, No.1, pages 279—300.

Allan Morris (2009), Managing creditors, an Extract from Owner Manager Working Capital Management guide, January 2009.

B Bagchi, B Khamrui (2012), Relationship between Working Capital Management and Profitability: A Study of Selected PMCG Companies in India, a Business and Economics Journal, Vol. 2012: BEJ-60.

BID network foundation (2008), Investing in Small and Medium sized enterprises in Uganda 2008, BID network country guide series.

Charlie C. (2009), Billing for beginners: How to manage your accounts receivables, an online article, Chargify.com.

Crestwell, J. W. (2003), Research design: Qualitative, quantitative and mixed methods approach, 2’~ edition, London.

Gabriel Hatega (2007), SME Development in Uganda, Workshop presentation, Private sector Foundation Uganda.

Gabriel Hatega (2007), SMEs Development in Uganda. PSF-Uganda.

Global Entrepreneurship Monitor, 2004, GEM Uganda 2004 executive report

Haitham Nobanee (2009), Working Capital Management and Firm Profitability: An Optional Cash Conversion Cycle, A working paper series, Abu Dhabi University.

James C. Van Home and John M. Wachowicz, Jr (2000). Fundamentals of financial management 11 edition, Prentice Hall, USA.

Julius Kakuru (2008), the supply-demand factors interface and credit flow to small and micro enterprises (SME5) in Uganda, PHD thesis, University of Sterling.

loannis Lazaridis and Dimitrios Tryfonidis (2006), The relationshj7’ between working capital management and profitability of fisted companies in the Athens Stock Exchange Journal of Financial Management and Analysis, Vol. 19, No. 1, January-June 2006.

Louis Kasekende and Henry Opondo (2003), Financing Small and Medium-scale Enterprises (SME5): Uganda~ Experience, Working paper, Bank of Uganda.

Mamoun M. Al-Debi’e (2011) Working Capital Management and Profitability: The Case Of Industrial Firms in Jordan, European Journal of Economics, A Finance and administrative Sciences ISSN 1450-2275 Issue 36 (2011).

Mansueto Ventures LLC (2009), Cash managemen4 Inc.com, World Trade Center, New York.

Ministry of Tourism, Trade and Industry and United Nations industrial development Organisation (2007), Integrated Industrial Policy for Sustainable Industrial Development and Competitiveness. Vienna.

Odi Nwankwo and G. Solomon Osho (2010), An Empirical Analysis of Corporate Survival and Growth: Evidence from Efficient Working Capital Management an International Journal of Scholarly Academic Intellectual Diversity, volume 12, Number 1.

Pedro Juan Garcia and Pedro Martinez-Solano (2007), Effects of working capital management on SME profitability An International Journal of managerial finance Vol 3 No. 2.

Sayeda Tahmina Quayyurn (2012), Relationship between Working Capital Management and Profitability in Context of Manufacturing Industries in Bangladesh, An International Journal of Business and Management Vol. 7, No. 1; January 2012**.**

Simone Rauscher and John R.C. Wheeler (2011), the importance of working capital management for hospital profitability: Evidence from bond-issuing, not-for-profit US. Hospitals, a Health care Manage Review, June 2011.

TM Pandey 2005, financial management, 8^{th} edition, Vikas Publishing House PVT LTD, New Delhi.

Uganda Bureau of Statistics (2011), Report on the Census of business establishment,

Van Hone (1980), financial management, 8th edition, Dryden Press, New York.

Vs Rama Rao (2009), factors affecting working capital needs, Citeman Network.