



**TREND ANALYSIS ON WORKING CAPITAL MANAGEMENT IN CASE
OF EDEN BUSINESS SHARE COMPANY.**

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ABSTRACT

Working capital management (WCM), which was defined as the management of short term liabilities and short term assets has significant importance for the success of the firm. Thus this research had been conducted with the purpose of trend analysis on working capital management of Eden business Share Company. The main objective of the study was to assess managements attitudes towards controlling working capital at satisfactory level and to keep production on an interrupted throughout physical year in Eden business Share Company. It has also look to related literatures for both the theoretical and empirical part to get better insight and to discover their gap. The research was design in the methodology part to figure how it had been conducted. The research has used both primary and secondary data. After the data had been gathered, it had been analyze and present the data analysis had been carry out based on ratio and percentage method. In the researcher knowledge there was no research done in Eden business Share Company and in the topic of trend analysis on working capital management. Therefore this research was address such gap by designing proper methodology, data presentation and analysis, conclusion and recommendation was presented. Finally reference and appendix presented in the research paper.

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LIST OF ACRONYMS

CCC = Cash conversion cycle

AAI = Average age of inventory

OC = Operating cycle

ACP = Average collection period

APP = Average payment period

EOQ = Economic order quantity

SNNPR=Southern nation nationalities, peoples and region

WCP=Working capital management

WC= Working capital

NWC=net working capital

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CHAPTER ONE: INTRODUCTION

1.1, BACKGROUND OF THE STUDY

Working capital management is a company managerial accounting strategy designed to monitor and utilize the two components of working capital, current assets and current liabilities, to ensure the most financially efficient operation of the company. The goal of working capital management was to manage a balance between profitability and risk that contributes positively to the firm's value. The lower the investment were lead to the higher the risk of not being able to pay debts as they come due. And the higher net working capital or lower current liability and higher current assets, financing also reduced the profitability due to high cost of financing from long term this to be compensated by reduced risk this gave the firm ability to meet its liability without difficult. And when the firm finances from short term, implies net working capital was negative this shows higher current liabilities than current asset as this time, with in short period of time the firm had been un able to meet in short period of time the firm had been unable to meet its liability. Therefore, all these situations greatly lead to lower the firm value. (Pandey, 2005)

Thus the study of the working capital management and source of finances for the working capital was an essential part of managing day-today activities of the firm. A firm started operation maintaining a minimum cash balance on hand and purchases raw materials to produce inventories of finished goods, which was then sold to customers. The sales of these goods realize cash or receivables. When the firm collected receivables, from debtors, it realizes the cash. The purchase of raw materials may also be credit payables after realization of cash from the sale of finished goods; the firm disburses its payables. Therefore, the working capital requirement of a company in turn affected by the size of these stated elements to completes their process. (Eljelly, 2004).

The working capital management also examined the aggressive /conservative working capital investment and financing policy. Wajahet and syed (2010), Vishnani S and shah B (2007) argue that working capital was just an idle resource with a high cost and low benefit associated with it so they advised companies to follow zero working capital policy but such a policy was very risky because it reduces the liquidity and it might leads to a default. According to researcher it was

advisable to a company to have a working capital policy because they believe that proper management of components of working capital can balance cost and benefits of the company and it has reduced the risk of default by raising liquidity. Companies can choose among three different types of working capital i.e. aggressive conservative and moderate but their choice depends on their desire levels of liquidity and risk.

According to the researcher knowledge there was no research have done in Eden business Share Company; therefore this study had been examined the trend of working capital management in Eden business Share Company.

1.2. Statement of the Problem

In every organization the working capital was important to maintain the smooth running of business, the motive power of business enterprise provided by working capital components; current assets such as; cash, receivable, and inventory and current liabilities and poor control over these current assets had been lead to incurring losses. I.e. inventories were valuable only if they can be sale and cash was useful if it was not idle or if there was no shortage of it's similarly, if the level of the working capital was in adequate to meet requirements of the customers if leads to loss of sale, loss of customers and loss of profit. In generally, the day-to-day activities failure in working capital management may result in the bankruptcy of the organization.

One of the major functions of finance was to raise capital. Traditionally, finance managers and for that matter businesses have to rely on banks, the stock market and equity capital. They gave less attention to efficient working capital as a viable means of raising capital. They seem not to appreciate the feasibility of raising capital through efficient working capital management. Nonetheless, efficient working capital management is one of the main sources of raising capital, Nyamao et al (2012). Secondly, in a study by Nyamao et al (2012), it has been acknowledged that at least sixty percent of businesses fail by year four. They attribute working capital management as one of the causes of these failures. Thirdly, in a recent discussion with the managers of that they have been faced ever increasing pressure on cost and growing financing requirements as a result of intensified competition from foreign markets.

In identifying possible options on the part of these businesses, it is important not to focus exclusively on income and expense items but also to take efficient working capital management

practices as an effective way to increase the value of the markets and distributors, release liquid resources, improve fresh cash flow and reduction in both inventory and capital cost. This partly explains the need for this study. The financial system where capital markets are less developed and banks play an important role, nonetheless, how to secure financing from these banks have become very difficult in Ghana (Kwame, 2007; Adjei & Marfo-Yiadom, 2006).

In context of Ethiopia there were few studies related to the issue of working capital management. Tewodros (2010) studied its impact on profitability of manufacturing firm with reference to Ethiopia on working capital management and firm profitability, Wubshet (2014) examined the impact of working capital management on firms. But no one was emphasized on core business operations of business having good working capital management trend analysis of manufacturing share companies. According to prior researchers finding, in Ethiopia many private and public manufacturing sectors do not carrying out working capital management practice due to obsolete business process and structure of the company. As a result there was huge deficiency problem in manufacturing sector Samuel and Tarekegn (2011). Therefore; firms related to this sector were the target respondents for measuring the perception and the application of the working capital management. Still manufacturing sector in Ethiopia adopts comprehensive working capital management; this had been directly affecting profit and value maximization of the organization. (Ephrem, 2011).

Thus the researcher has conduct deep investigation in order to contribute some solution to the existing gap and problems: change traditional working capital management in to modern one, to control the cost of holding current asset, to ensure the adequate level of current asset, to avoid the loss caused by inadequate working capital, to control technical insolvency. The aim of this research was to examine trend analysis on working capital management especially for Eden business Share Company. The knowledge of the researcher the empirical studies on the working capital in case of Eden business Share Company were not done. Therefore this research was examine the trend analysis of Eden business share companies' working capital management thus the researcher has conducts this research with the aim of providing answer the following basic research questions.

1.3 Research Question

1. What are the different strategies had been used the company to manage the components of working capital?
2. What source of finance does the company use?
3. What the company current capacity to meet its liability?
4. What type of advice is suggested to improve working capital management of the firm?
5. What are the proportions of working capital management in Eden business Share Company?

1.4. Objective of the research

1.4.1. General Objective

The general objective of the research was trend analysis on working capital management in Eden business Share Company.

1.4.2. Specific Objective

The specific objective of the research was as follows:

- To assess the proper working capital management of the firm.
- To identify strategies of the firm that is used to manage various components of its current asset.
- To investigate the source of finance for current asset.
- To suggest advice for improving the working capital management of the firm.
- To assess the proportion of working capital management in Eden business share company

1.5 Significance of the research

Because of less awareness of many firms how to manage their working capital, working capital was necessary and current issue. Due to these the firms are going to bankrupt and come to an end their operation. Therefore result of this research was expected to benefit institutions and managers to have awareness of the position of working capital of the firm and it also provides manager some possible techniques for the management of the working capital.

The result was also expected to inspire the firm to manage its working capital in proper manner, to ensure maintains of solvency to have good image without side world. Thus, this study was very significant as it focuses on the back bone of the firm. This research was extremely important to: Provide useful information for proper management of each component of working capital of the firm, offer suggestion and comments on the company's operation, provide information for further researchers, it also serves as reference for better working capital management and effectiveness in the country level, it was serve the researcher to acquire BA degree in accounting and finance and also to have knowledge and experience in related courses.

1.6 Scope of the study

The research has been conducted in Eden business Share Company, the researcher has used for five years (2006-2010) data by using both primary and secondary data to assessed trend analysis of working capital management, in the primary data the researcher used questionnaire and in the secondary data used five years financial statements and other documentary materials. The basic liquidity measures are used to compare financial position of Eden Business Share Company for past five year's balance sheet if used as source of data.

1.7 Limitation of the research

When conducting this research, the researcher had faced certain constraint which limited the scope of the research. Among those constraints the most significant are the following.

- Financial problem: This limits the scope of research by blocking the study not progress as if it is needed. As example in this research the secondary data collected from the Eden business share company head office found in Addis Ababa, so the transportation cost are high.
- Because of high competition among different firms producing the same product like Eden business Share Company, the company does not like to gave all necessary real information because of secret internal policy, rule, and procedure that company has been using to cope up with the competition.
- Time problem or limitation: due to short period of time, it was difficult to gather a complete relevant information

1.8 Organization of the research

The research contains five chapters, Chapter one presents the introduction part, which includes background of the study, statement of the problem, objectives of the study, research question, significance of the study, scope of the study and organization of the research proposal. Chapter two presents with review of related literature. Chapter three states research design and methodology, which includes introduction, research approach, research design, description of the study area, data source and collection, population, sample size and sampling technique, method of data analysis, Chapter four presents about data presentation and analysis, Chapter five presents conclusion and recommendation, Finally reference and appendix was presented in the paper.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

This chapter includes the theoretical review of literature in which the study based on. The researcher provides to the working capital management and its apparatus. The researcher was further, present literature review of empirical studies. Finally, the nature and the scope of working capital management, conclusion and knowledge gap presents.

2.1 Theoretical Review of Literature

2.1.1 Concepts and nature of working capital management

The current assets, commonly called working capital represent the portion of investment that circulates from one form to another in the ordinary conduct of business. This idea embraces the recurring transaction from cash to inventories, then to receivables and back to cash that forms the operating cycle of the firm.

There are two types of working capital; permanent and temporary (fluctuating variable) working capital. Permanent working capital was a minimum amount (safety stocks of cash and inventories) required to be keeps in the form of current assets. It is a fund required for the data-to-day operational activities of the firm.

Temporary working capital (fluctuating/seasonal) was the amount required to meet seasonal demands. Current liabilities represent the firms short term financing because they include all debts of the firm that come due (must be paid) in one year or below one year.

Net working capital (NWC) is defined as the difference between the firm's current assets and current liability. If the firm has positive net working capital, it is the portion of the firms current assets are financed with long-term funds, meaningless short term funds financed with more long-term funds. And if the firms networking capital is negative shows the current liabilities exceed

the current assets. So, the firm is financing from less long-term funds with more short-term fund (aggressive. Strategy)

The concept of net working capital is useful to groups interested in determining the amount and nature of assets that may be used to pay current liability. (V.K Bhalla, 2003; Working capital management ANONI Publication New Delhi).

There are three strategies, but two of them are more basic (aggressive and conservative) for determining an appropriate mix of short-term or current liability and long-term financing.

An aggressive financing strategy calls for firm financing to meet at least its seasonal requirements and possibly some its permanent requirements with short-term funds, the balance is financed with long-term funds under which restricted policy current assets are turned over more frequently and the holding cash, securities, inventories and receivables are minimized (firm is financing more from short-term fund). This increases profitability of the firm. However, is risk, the firm's ability to meet its liability is less when it comes due or unable to meet liability.

Conservative financing strategy, under this strategy relatively large amounts of cash, marketable securities and inventories are carried, and sales are stipulated by liberal financing policy (relaxed collection period) to customers a corresponding high level of receivables are bound to occur (firm finances more from long-term funds). Use shot-term financing in the event of an emergency or unexpected out flow of funds. It is difficult to imagine how this strategy could actually be implemented, because the use of short-term financing tools, such as account payables and accruals are virtually un avoidable unlike the aggressive strategy, the conservative strategy required the firm to pay interest for un needed funds.

Many authors agree that the two concepts. Such as, liquidity ratio and techniques of managing current assets are important in managing working capital effectively under techniques of managing current assets: the cash conversion cycle, technique of maintaining cash, factors influencing the choice of marketable securities, factors used to investigate potential customers. Inventory management and source of short-term financing are included.

(Bodil dick in son B.J campsey Eugene F. Briahm, 1997).

According to the opinion of ratio analysis (financial ratio analysis) provides the following information.

- Ratio analysis is the one of the most important concepts in analysis of effective working capital management. Because it provides the meaningful comparison to its industry and it is the most powerful tools of financial analysis.
- Ratio analysis is the method of calculating and interpreting financial ratio to assess the firm's performances and status.
- Financial ratio shows the relationship among statement accounts, enable quick comparison of firms in a given industry and comparison is made to some industry.

2.1.2 Liquidity

Liquidity refers to the solvency of the firms over all financial position there as with which can pay its bills. The three basic measures of liquidity are:

- Net working capital
- The current ratio
- Quick (acid-test) ratio

Liquidity ratio has two parts, current ratio and quick ratio. Current ratio is the measure or expresses the relationship between firm's current assets and its current liability, and it is calculated as current assets divided by the current liability. The result shows the liquidity position of the firm.

To high current ratio indicates the firms holding of excessive current asset and to low current ratio indicates poor ability to satisfy short term obligation or liability. A current ratio of value depends on the industry in which the firm operates reference.

(Pandey, 2005).

Current ratio measures short-term solvency of the firm. High ratio indicates good liquidity position, increase in current liabilities faster than current assets indicates to the firm a bad

liquid position that means the firm unable to meet its liability when comes due. Quick ratio is also called acid-test ratio, it is the strength test of liquidity, it is calculated by dividing the firm's current asset minus inventories by current liabilities; quick ratio= Current asset- Inventory/current liabilities.

Excessive liquidity reduces a firm's risk of being unable to satisfy short-term obligation as they come due, but sacrifices profitability, because;

- I. Current assets are less profitable than fixed assets and
- II. Current liabilities are less expensive financing sources than long-term funds. Quick ratio measures the ability to pay of its short-term obligation without relying on the sale of inventory. The higher ratio, the higher the firm's liquidity position.

2.1.3 Current asset management

This was also another important concept in working capital management. The technique of current asset management includes: Technique of cash management, receivable management, marketable security management, inventory management and source of financing them. There are two major objectives of current assets management.

- I. Being to minimize cash operating cycle, and
- II. Being to finance those assets as effectively as possible with the overall objective of optimizing the return on total capital employed.

2.1.4 Cash management technique

Cash is ready currency to which all liquid assets can be reduce, cash balances were significantly influenced by firm's production and sales. Techniques and by its procedures for collecting sales receipt and paying for purchases. These influences can be better understand through analysis of the firms operating and cash conversion cycle (CCC).

2.1.5 Operating cycle

Operating cycle is the length of time that elapses from the points when the firms begin to build the inventory to the point when cash was collected from the sale of the resulting finished product. The cycle is made up of two components the average age of inventory, and

the average collection period of sales. The firm operating cycle (OC) is the sum of average age of inventory (AAI) and the average collection period (ACP).

$$OC = AAI + ACP$$

Average age of inventory is the length of the time required to produce and sell the product.

$$AAI = \frac{\text{Average Inventory}}{\text{Cost of sales}/365 \text{ days}}$$

The average collection period (ACP) represents the length of time required to collect the sales of receivables.

$$ACP = \frac{\text{Account receivables}}{(\text{Annual credit sales})/365}$$

2.1.6 Cash conversion cycle (CCC)

The cash conversion cycle represents the amount of time the firm's working capital is tied up between payment for production input and receipt of payment from the sale of the resulting finished products. It is calculated as the number of days in the firm's operating cycle minus the average payment period for inputs to production. Cash conversion cycle = operating cycle - Average payment period (CCC = OC - APP).

Average payment period (APP) is the length of time the firm is able to defer payment on its various resource purchases. Ideally, the firm likes to have a negative cash conversion cycle, which means the average payment period exceeds the averages of inventory plus the average collection period. In contrast to manufacturing,

firms usually do not have negative cash conversion unless they extend their average payment period to an unreasonable length of time. But a firm needs to pursue strategies to minimize it without causing harm to the company in the form of lost sales or inability to purchase on credit. The basic strategies that should be employed by the firm to manage cash conversion cycle are:-

- Turn over inventory as quickly as possible avoiding stock outs that might result in loss of sale

- Collects accounts receivable as quickly as possible without losing future sale because of high pressure collection technique.
- I. Pay accounts payable as late as possible without damaging the firm's credit rate, (James C. Van Horne, 1998). And (Bodil Dickinson B.J campsey Eugene F. Briahm, 1997).

2.1.7 Management of marketable securities

Marketable securities are short term interest earning and money market instrument used by the firm to obtain a return on temporarily idle fund. When fund are being hold for other than immediate transaction purpose (cash) they should be converted from cash to interest bearing marketable securities from return point up to upper limits is achieved. Under normal conditions, the longer the maturity period of securities, the higher they yield. A wide variety securities, differing in terms of default risk; interest rate risk, liquidity risk, inflation risk and expected rate of return available to firm that choice to hold marketable securities (Fundamental of financial management. Theory and practice Brightam, Ehrardt, 2002).

2.1.8 Management of Account Receivables

Account receivables represent the extension of credit by which the firm gives to its customers. The extensions of credit to customers by most manufactures are a cost of doing business. By keeping its money tied up in account receivable, the firm loses time value of money and runs the risk of non-payment by its customers.

The level of account receivable should not be judged too high or too low based on historical standards of industry norms, but the test should be whether the level of return we are able to earn from this asset equal or exceeds the potential gain from other investments. We must ask whether we are optimizing our return in light of appropriate risk and liquidity consideration.

Generally, the firm financial manager directly controls account receivable through involvement in the establishment and management of

- Credit policy
- Collection policy

Credit policy is the determination of credit selection, credit standards and credit-terms. Credit selection is the decision whether to extend credit to customer and how much credit to extend.

The collection policy should consider the both firm's and its customer interest because of extended collection period and the customers of the firm. It is bad for the firm extended collection period, but preferable by customers of the firm. Therefore, the collection period has to consider both the firm's and its customer interest.

2.1.9 Inventory Management

In manufacturing company, inventory is usually divided into three basic categories: raw material, work in process (partially finished goods) and fully finished good. (This is ready for sale) All these forms of inventory need to be financed, and their efficient management can increase the firm profitability.

In developing inventory managing techniques we must evaluate two costs associated with inventory, the carrying cost and ordering cost. Carrying cost includes interest on funds tied up in inventory and cost of warehouse space, insurance premium and materials handling expenses. There is also implicit cost associated with the danger of obsolescence or price changes. The larger the order, the greater the average inventory we had been on hand and the higher carrying cost.

Ordering costs if we maintain relatively low average inventory in stock we must order many times and total ordering costs will be higher. As the order size increases, carrying cost goes up because we have more inventory on hand.

Economic ordering quantity (EOQ) the most advantageous amount for the firm to order each time mathematically it can be determined as

$$EOQ = \sqrt{\frac{2(S)O}{C}}$$

Where S= Total sales in unit
O = Ordering cost for each order
C = Carrying per unit in dollar

2.2.1 Need for working capital

The need for working capital to run the day-to-day business activities cannot be over emphasized. We had hardly find a business firm which does not require any amount of working capital. Indeed, firms differ in their requirements of the working capital. We know that a firm should aim at maximizing the wealth of its shareholders. In it's to do so, a firm should aim at maximizing should earn sufficient return for its operations. Earning a steady amount of profit requires successful sales activity. The firm has to invest enough funds in current assets for generating sales. Current assets are needed because sales do not convert into cash instantaneously. There is always an operating cycle involved in the conversion of sales into cash (Pandey. 8th edition)

2.2.2 Balanced working capital position

The firm should maintain a sound working capital position. It has adequate working capital to run its business operations. Both excessive as well as inadequate working capital positions are dangerous from the firm's point of view.

Excessive working capital means idle funds which earn no profits for the firm. Paucity of working capital not only impairs the firm's profits ability but also results prevention, interruption and inefficiencies.

The dangers of excessive working capital and as follows:-

- ✓ It results in unnecessary accumulation of inventories thus, chances of inventory mishandling, waste, theft and losses increase.
- ✓ Excessive working capital makes management complacent which degenerates into managerial inefficiency.
- ✓ Tendencies of accumulating inventories tend to make speculative profits grow. This may tend to make dividend policy liberal and difficult to cope with in future when the firm is unable to make speculative profits.
- ✓ Fixed assets are not efficiently utilized for the lack working capital funds. Thus, the firm's profitability would deteriorate.
- ✓ Operating inefficiencies creep in when it becomes difficult even to meet day – to day commitments.

- ✓ Paucity of working capital funds render the firm unable to avail attractive credit opportunities etc.

2.2.3 Determinates of working capital

There is no set of sales or formulate to determine the working capital requirements of firms. A large number of factors each have a different importance to influence working capital needs of firm. Also, the importance of factors changes for a firm overtime. Therefore, an analysis of relevant factors should be made in order to determine total investment in working capital. The following is the description of factors which generally influence the working capital requirements of the firms.

1. Nature of Business

Working capital requirements is a firm basically to influence by the nature of its business. Trading and financial firms have a very small investment in fixed assets, but require a large sum of money to be invested in working capital. Retail stores, for example, must carry large stocks of a variety of goods to satisfy varied and continues demands of their customers. Some manufacturing business, such as tobacco manufactures and construction firms also have invested substantially in working capital and a nominal amount in fixed assets. Public vitalities have a very limited need for working capital & have to invest abundantly in fixed assets. Their working capital requirements are nominal because they may have only cash sales and supply services, not products.

Working capital requires most of the manufacturing concerns to fall between the two extreme requirements of trading firms and public utilities, such concerns have to make adequate investment in current assets depending upon the total assets structure & other variables.

2. Sales and demand condition

The working capital needs of a firm are related to its sales. It is difficult to precisely determine the relationship between volumes of sales and working capital needs. In practice, current assets will have to be employed before growth takes place. It is, therefore, necessary to make advance planning of working capital for a growing firm on continuous basis. A

growing firm may need to invest funds in fixed asset in order to sustain its growing production and sales.

Sales depend on demand conditions. Most of the firms experience seasonal and cyclical fluctuations in the demand for their products and services. Their business variations affect the working the working capital requirement, specially the temporary working capital requirements of the firm. When there is an upward saving in the economy, sales will increase; correspondingly, the firm's inventories and debtors will also increase. Under boom, additional investment in fixed assets may be made by some firms to increase their productive capacity this act of firms will require further additions of working capital.

3. Technology and Manufacturing policy

The manufacturing cycle (or the inventory conversion cycle) comprises of the purchase and use of raw materials and the production of finished goods. Longer the manufacturing cycle, large will be the firm working capital requirements.

4. Credit policy

The credit policy of the firm affects the working capital by influencing the level of debtors. The credit terms to be granted to customers may depend up on the norms of the industry to which the firm belongs. But affirm has the flexibility of shaping its credit policy within the constraint of industry norms & practice.

The firm should use discretion in granting credit terms to its customers. Depending up on the individual case, different terms may be given to different customers. A liberal credit policy, without rating the credit-worthiness of customers, will be determine to the firm and will create a problem of collecting funds later on. A high collection period will mean tie-up of large funds in book debts, slack collection procedures can increase the chance of bad debts.

In order to ensure that unnecessary funds are not tied up debtors, the firm should follow a rationalized credit policy based on the credit standing of customers and other relevant factors. The firm should evaluate the credit standing of new customers and periodic any review the credit worthiness of the existing customers.

5. Availability of credit

The working capital requirements of a firm are also affected by credit terms granted by its creditors. A firm will need less working capital if liberal credit terms are available to it. Similarly, a firm that can get bank credit on easy and favorable conditions will operate with less working capital than a firm without such a facility.

6. Operating Efficiency

The operating efficiency of the firm relates to the optimum utilization of resources at minimum costs. The firm will be effectively contributing in keeping the working capital investment at a lower level if it is efficient in controlling operating costs and utilizing current assets. The use of working capital (WC) is improved and the cash conversion cycle is accelerated with operating efficiency. Better utilization of resources improves profitability and, thus, helps in releasing the pressure on working capital. Although it may not be possible for a firm to control prices of materials or wages of labor, it can certainly ensure efficient use of its materials, labor and other resources.

7. Price level changes

The increasing shifts in price level make the functions of financial manager difficult. He should anticipate the effect of price level changes on working capital requirements of the firm. Generally, rising price levels will require a firm to maintain a higher amount of working capital. Some levels of working current assets will need higher investment when prices are increasing. However, companies which can immediately rise levels will not face a severe working capital problem.

Further, effects of increasing general price level will be felt differently by firms as individual prices may move differently. It is impossible that some companies may not be affected by rising prices while others may be badly hit by it. Thus, the effect of rising prices will be different for different companies. Some will face no working capital problem, while the working capital problems of others may be aggravated.

2.2.4 Issues in working capital Management

Working capital management refers to the administration of all aspects of current assets, namely cash, marketable securities, debtors and (stock) inventories and current liabilities. The financial manager must determine levels and composition of current assets. The manager must see that right sources are tapped to finance current assets, and many current liabilities are paid in time.

There are many aspects of working capital management which make it an important function of the financial manager.

- ✓ Time working capital management requires much of the financial manager's time.
- ✓ Investment working capital represents a large portion of the total investment in assets.
- ✓ Criticality working capital management has great significance for all firms but it is very critical for small firms.
- ✓ Growth the need for working capital is directly related to the firm's growth.

Working capital management is critical for all firms, but particularly for small firms. A small firm may not have much investment in fixed assets, but it has to invest in current assets, small firms in India face a severe problem of collecting their debtors (book debts or receivables). Further, the role of current liabilities in financing current assets is far more significant in case of small firms, as unlike large firms, they face difficulties in raising long-term finances.

There is a direct relationship between a firm's growth and its working capital needs. As sales grow, the firm needs to invest more in inventories and debtors. These needs become very frequent and fast when sales grow continuously. The financial manager should be aware of such needs and finance them quickly. Continuous growth in sales may also require additional investment in fixed assets.

It may, thus, be concluded that all relations should be taken for the effective and efficient management of working capital. The finance manager should pay particular attention to the levels of current assets & the financing of current assets. (Pandey, 8th edition)

2.2.5 Estimation Working Capital needs

The most appropriate method of calculating the working needs of a firm is the concept of operating cycle. However, a number of other methods may be used to determine working capital needs in practice. We shall illustrate here three approaches which have been successfully applied in practice:

- Current assets holding period- To estimate working capital requirements on the basis of average holding period of current assets & relation them to costs based on the company's experience in the previous year. This method is essentially based on the operating cycle concept.
- Ratio of Sales – To estimate working capital requirements as a ratio of sales on the assumption that current assets change with sales.
- Ratio of Fixed investment – To estimate working capital requirement as a percentage of fixed investment.

2.2.6 Source of Finance

A firm can adopt different financing policies of current assets.

Three types of financing may be distinguished:

- 1. Long – term financing** – The source of long-term financing include ordinary share capital. Preference share capital, debentures, long-term borrowings from financial institutions and reserves and surplus (retained earnings)
- 2. Short – term Financing** – The short term financing is obtained for a period, less than one year. It is arranged in advance from banks and other suppliers of short –term finance in the money market. Short-term finance include working capital funds from banks, public deposits, commercial paper, factoring of receivable etc.
- 3. Spontaneous Financing** - Spontaneous financing refers to the automatic sources of short term funds arising in the normal course of a business. Trade (suppliers') credit and outstanding expenses are examples of spontaneous financing.

There is no explicit cost of spontaneous financing. A firm is expected to utilize these sources of finance to fullest extent. The real choice of financing current assets, once the spontaneous source of financing have been fully utilized, is between the long-term and short –term source of finances.

Depending on the mix of short-term and long –term financing, the approach followed by a company may be referred as:-

- Matching approach
- Conservative approach
- Aggressive approach

➤ **Matching approaches**

The firm can adopt a financial plan which matches the expected life assets with the expected life of the source of funds raised to finance assets. Thus, a ten year loan may be raised to finance a plant with an expected life of ten years; stock of goods to be sold in thirty days may be financed with a thirty –day commercial paper or a bank loan. The justification for the exact matching is that, since the purpose of financing is to pay assets, the source of financing & the asset should be relinquished simultaneously.

Using long-term financing for short –term assets is expensive as funds will not be utilized for the full period. Similarly, financing long-term assets with short-term financing is costly as well as inconvenient as arraignment for the new short term financing will have to be made on a continuing basis. When the firms follows matching approach (also known as hedging approach), long term financing will be used to finance fixed assets and permanent current assets and short –term to finance temporary or variable current assets. However, it should be realized that exact matching is not possible because of uncertainty about the expected lives of assets.

➤ **Conservative approach**

A firm in practice may adopt a conservative approach in financing its current and fixed assets. The financing policy of the firm is said to be conservative when it depends move on long –term funds for financing needs. Under a conservative plan, the firm finances its permanent assets and also a part of temporary current assets with long-term financing. The idle long-term funds can be invested in the tradable securities to conserve liquidity. The conservative plan relies heavily on long –term financing and, there for, the firm has less risk of facing the problem of shortage of funds.

➤ **Aggressive approach**

A firm may be aggressive in financing its assets. An aggressive policy said to be followed by the firm when it uses more short-term financing than warranted by the matching plan. Under an aggressive policy, the firm finances a part of its permanent current assets with short-term financing. Some extremely aggressive firms may even finance a part of their fixed assets with short-term financing.

➤ **Short-term Vs Long-term financing: A risk-return Trade-off**

A firm should decide whether or not it should use short-term financing. If short-term financing has to be used, the firm must determine its position in total financing. This decision of the firm will be guide by the risk-return trade-off.

Short-term financing may be prepared over long-term financing for two reasons.

- i. The cost advantage and
- ii. Flexibility, but short term financing is more risky than long-term financing.

2.3 Empirical Studies

Many researchers has studies working capital from different views and in different environment. (Eljelly, 2004) indicated that efficient liquidity management involves planning and controlling, current assets and current liabilities in such a manner they eliminate the in ability to meet due short term obligation and a voids excessive investment in these asset. The relation between profitability and liquidity was examined as measured by current ratio and cash gap (cash conversion cycle) on a sample of joint stock companies in save.

Modern financial management aims at reducing the level of current asset without ignoring the risk of stock outs. Efficient management of working capital is important indicator of sound health of an organization which requires reduction of unnecessary blocking of capital in order to bring down the cost of financing (Arshad 2013).

Weinraub and visscher (1998) study the issue of aggressive and conservative working capital policies. Their objective was to observe the differences in working capital policies as well as the long term stability of working capital policies over time. Current assets to total assets ratio and current liabilities to total asset ratio were used as working capital investment and financing policies. Most of the empirical studies regarding working capital management and

profitability relationship support the traditional belief that reducing current assets, would positively affect the profitability of firm (aggressive policy). (Deloof, 2003) discussed that most firms had a loss amount of can in working capital. It can therefore be expected that the way in which working capital is managed will have a significant impact on profitability of this firms

2.4 Conclusion and Knowledge gap

This chapter starts for the concept and nature of working capital management, there are two types of working capital: permanent and temporary working capital. The objective of working capital management is to meet due short – term obligation and avoids excessive investment in the assets. In this chapter to describe the factor which generally influence the working capital requirements of the firms, those are: nature of business, sales and demand condition, technology and manufacturing policy, credit policy, availability of credit, operating efficiency and price level change. Depending on the mix of short term and long-term financing are classified in to three approaches, thus are: matching, aggressive and conservative approaches. The other one is empirical studies it requires many researchers have studies working capital from different view and in different environment.

To the knowledge of the researcher the empirical studies on the area working capital management in case of Eden business Share Company were not done. This research therefore, seeks to contribute to this gap and identify which analysis of working capital has a significant effect in Eden business Share Company.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.0 Introduction

This chapter presents the data source, research approach, research design, description of the study area, the choice of data method, the data collection techniques and the data analysis technique prepare in this study.

3.1 Description of the study area

This research had been conduct on trend analysis on working capital management in Eden business Share Company; located in the south western part of Ethiopia, in the Southern Nations and Nationalities Peoples Regional State (SNNPR), in Guraghe zone, Edja Woreda Gedeb Kebele, at a distance of 204 km away from the center Addis Ababa.

3.2 Research approach

There are three research approaches: it includes quantitative, qualitative and mixed approaches. Quantitative approach is towards research is that the collection and analysis of information is conducted utilizing mathematically based methods. Qualitative approach is emphasis upon exploring and understanding the meaning of individuals and groups to describe issues from investigating them. Mixed approach is the researcher combine elements of qualitative and quantitative approaches. The researcher had been used mixed approach, because, it covers the weakness of one by others, and it enables the researcher to measure and arrange data and more detained or rich data in the form of comprehensive evidence to achieve the objective of the research.

3.3 Research Design

There are three research designs, such as: explanatory, exploratory and descriptive. Exploratory is detective work by curiosity and it is advisable for researcher used to find venture in to new territories in search of information. Descriptive is as the name suggests is used to description or to describe phenomenon or idea. Explanatory is effective in terms of identifying, co variation

between variables. The researcher had been used descriptive research design. Because, the aim of the research was to describe or assess trend analysis on working capital management in Eden business share company.

3.4 Data source and collection method

The researcher has used both primary and secondary source of data. The primary source of data was open ended questionnaire to get possible responses from different groups; from those: customer service officer, the branch controller and based on their departments position and occupation. The secondary data was collected from published financial statements and reference books and related written materials that support to this study.

3.5 Population

The total population of the employee of the organization was 26. From those 26 employees the researcher has used 13 employees for responding the given questionnaire to conduct the research.

3.6 Sample size and Sampling techniques

The method of sampling techniques that the researcher has used probability sampling techniques to select a sample from different employees including: Accountants, distributor and sale and promotion department. To select a sample from the population the researcher has used simple random sampling method because it gives equal chance for the samples select, it is easy to select and obtain necessary and sufficient information, convenient to use, require low cost and consumes less time for the researcher to conducted the research.

$$\begin{aligned}n &= N / (1 + N (e^2)) \\ &= 26 / (1 + 26 (0.05^2)) \\ &= 24.41\end{aligned}$$

In circumstance, where there are small population elements the sample will be equal to the population in such case we can adjust the sample calculated by the formula:

$$\begin{aligned}n &= n / (1 + (n/N)) \\ &= 24.41 / (1 + (24.41/26)) \\ &= 13\end{aligned}$$

3.7 Method of data analysis

After necessary data was collected from the primary sources and secondary sources the data had been analyzed by using descriptive statistics. The researcher was used descriptive data analysis method that was used to analyze the responses of the respondents and discussions to analysis of working capital management in Eden business share company. The most important activities of data analysis were started by editing and classifying the collecting data in to more meaning full and relevant information. Therefore, in this study the data was analyzed through descriptive method. In descriptive method, the study result comply in the form of table, percentage, ratio method to describe working capital management in Eden business Share

CHAPTER FOUR

Data Presentation and Analysis

4.0 Introduction

The findings of the data presentation and analysis are based up on the analysis of five years financial statements of Eden Business Share Company and different financial management and working capital concepts. The following are the results and discussion of data collected from both questionnaire and documentary evidences, the researcher has distributed thirteen (13) questionnaire from that the researcher collected nine of them and this analysis done based on collected questionnaire because of the company manager and employees are busy to filled the data by this way the remaining four (4) paper are not filled properly.

4.1. Personal Attributes of Respondents

Table 1 Personal attributes of respondents

Respondents		N ^o	% age
Age	18-25	2	22.2
	26-40	3	33.3
	41-60	4	44.4
	Total	9	100
Sex	Male	7	77.8
	Female	2	22.2
	Total	9	100
Educational level	Degree	7	77.8
	Diploma	2	22.2
	Master degree	-	-
	PHD	-	-
	Total	9	100
Experience	< 5 years	7	77.8
	6-8 years	2	22.2
	>10 years	-	-
	Total	9	100

Source: questionnaire

As it presented in the above table most of the respondents, four (44.4%) are in between 41-60, three (33.3%) of them are between 26-40 and the rest, 2 (22%) respondents are between 18-25 years, this result shows the organization were running the business by young employees.

As the above table shows, among respondents there are two females and seven males and their percentages are 22.2% and 77.8% respectively. Regarding to their educational status two or 22.2% of diploma holders and seven or 77.8% are degree holders.

Finally, pertaining to their experience of job seven or 77.8% of respondents have less than five year experience, two or 22.2% of them have six up to eight years' experience and most of the respondents have less than five year experience and this shows majority of respondents are degree holders and most of respondents are experienced, this information mainly related with the company working capital managements with to report for work fit in mental and physical conditions.

4.2 Type and Source of Raw Material

Respondents answers to the questions asked about the raw material and its source, all of the respondents answered the main raw material of the factory is label, shrink film, neck sleeve, ash solution and chemicals.

4.3 Working Capital Issue

Table-2 Working capital issue

Nº	Statement		No of Respondents	% age of Respondents
1	How do you control your working capital?	Using working capital ratio analysis	8	88.8
		Using cash operating cycle	1	11.2
		Just on time system	—	—

		Others	-	-
		Total	9	100
2	Do you reserve a desired minimum cash balance?	Yes	9	100
		No	-	-
		Total	9	100
3	If there is a cash deficit how does the factory overcome (finance) it?	Short-term borrowing	3	33.3
		Use trade credit	6	66.67
		Other	-	-
		Total	9	100
4	Does your company have an overall policy for the management of its working capital?	Formal	3	66.7
		Informal	6	33.3
		No policy	-	-
		Total	9	100
5	Who sets the management policy for working capital for your company?	Board of directors	5	55.6
		president	2	22.2
		Vice president	2	22.2
		Total	9	100

Source: questionnaire, as it is presented in the table above for the statement asked about how the company controls its working capital, all (88.8%) of the respondents responded that as the company used to manage its working capital.

As one can see from number 2 of the above table all (100%) of the respondents said yes. This result shows that as the company places cash for short-term financing needs.

Regarding the statement asked how the company finance itself at the time of cash deficit, above half or six (66.67%) of the respondents answered as the company finance itself using trade credit. The remaining four (33.3%) respondents responded as the company finance itself by short term borrowing. This result shows as the company major finance source is trade credit followed by short term borrowing.

4.4 Organizational issues related to Working capital

Table-3 Organizational issues related to Working capital

N ^o	Statement	N ^o of respondents	%	age	of
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			respondents	
1	When the Eden Business share company working capital requirement reach maximum?	During inflation	-	-
		During growth	-	-
		During operating efficiency	9	100
		Total	9	100
2	Does the company face with liquidity problems so far (risk of unable to pay short-term obligation)	Yes	2	22.2
		No	7	77.8
		Total	9	100
3	Does the Eden Business share company offer credit sales?	Yes	8	88.9
		No	1	11.1
		Total	9	100
4	Does the company offer discount period?	Yes	7	77.8
		No	2	2.2
		Total	9	100
5	Is Eden Business share company profitable?	Yes	9	100
		No	-	-
		Total	9	100
6	Loan size related to your business?	Short term	7	77.8
		Long term	1	11.1
		Middle term	1	11.1
		Total	9	100

Source: questionnaire, as one can understand from the above table number 1 about working capital requirement all of the respondents respond that the working capital requirement of the company is highest during operation efficiency. Regarding liquidity problem it is presented that the companies have faced with liquidity problem in the past because only two respondents say yes.

In question number 3 of the above table it is presented that as the company have offer a credit sale. This investigation has a positive procedure on the company sale. This is because the company has attracted customers who have cash sufficiency. The company has obtained a term loan from Birhan International Bank Sh.Co. Secured the against the company's plant and equipment and vehicles respectively. The loan bears an interest rate of 10.5% per annual, a loan made by a bank or financial institutions to a business having an initial maturity of

more than one year. The company credit policy relating to sales and purchase also affects the working capital, the credit policy influences in two ways such as, through credit terms by the firm to its customers or buyers of goods and credit term available to the firm from its creditors, it includes buying of raw material and selling of finished goods either in cash or credit, this affect the company cash conversion cycle.

4.5 Liquidity Measures

Liquidity position of the company is shown using different liquidity ratios which are useful to judge a company's ability to meet short-term obligations. The following basic liquidity measures are used to compare financial position of Eden Business Share Company for past five year's balance sheet if used as source of data.

4.5.1. Net working Capital

Net working capital is one of the most commonly cited financial ratios to meet firm's short-term obligation, which is denoted as current assets minus current liabilities and it expresses the difference between the two. Networking capital = current asset – Current liability

Table-4 Net working capital

Year	2010	2009	2008	2007	2006
Current Asset (CA)	85,420,089.64	86,736,663.32	112,321,115.36	77,210,747.03	39,480,147.37
Current liability (CL)	5,388,304.44	8,195,702.64	5,144,278.51	2,993,157.83	2,519,407.74
CA – CL	80,031,785.2	78,540,960.7	107,176,837	74,217,589.2	36,960,739.6

Source: Balance sheet from year (2006 – 2010)

As above table shows the company's networking capital for past five years was positive. Positive networking capital shows that current asset is greater than current liability. From this researcher concluded that the greater margin by which the company's current assets cover its short-term obligation, the better able it to pay its debt as they come due in generally the

company has been showing good position in meeting its current liability. However, current asset and liability have been increasing not in the same rate for the years to years.

4.5.2. Current Ratio

Current ratio is one of the most commonly cited financial ratios to meet the firm's short-term obligations when and as they fall due or at maturity. It expresses the relationship between the firm's current assets to current liability.

$$\text{Current ratio} = \frac{\text{Current asset}}{\text{Current liability}}$$

Then, it can be interpreted as, for one birr of current liability as if how much the companies birr could able to present from its current asset. (Financial management I.M pandey, 2005)

Table-5 Current ratio

Year	2010	2009	2008	2007	2006
Current assets (CA)	85,420,089.64	86,736,663.32	112,321,115.36	77,210,747.03	39,480,147.74
Current liability (CL)	5,388,304.44	8,195,702.64	5,144,278.51	2,993,157.83	2,519,407.37
$\frac{CA}{CL}$	15.9	10.6	21.9	25.8	15.7

Source: Balance sheet of EBSC from (2006-2010)

The greater margin by which firm's current assets covers its short-term obligation, the better able it will be to pay bills as they come due. In general the liquidity position of firm is good because company more than one (1) so, the liquidity of this company was suitable. However, when we compare years to years the two succeeding years was better those are 2007 & 2008, the remaining years of the liquidity position of the firm has been slightly decreasing than the prior one.

4.5.3 Quick Ratio

This ratio is somewhat more accurate guide to liquidity and it was the same as current ratio except that it excludes inventory which was least liquid asset. (Financial management I.M Pandey, 2005)

$$\text{Quick ratio} = \frac{\text{Current asset} - \text{Inventory (CA-I)}}{\text{Current liability}}$$

Table-6 Quick (acid test) ratio

Year	2010	2009	2008	2007	2006
CA	22,875,271.9	51,247,653.1	10,739,739.4	25,034,317.9	20,057,684.4
Inventory					
Current liability	5,388,303.44	8,195,702.64	5,144,278.51	2,993,157.83	2,519,407.74
Quick ratio	4.3	6.3	2	8.4	8

Source: Balance sheet of EBSC from year (2006-2010)

The quick or acid test ratio was greater occasionally recommended, but as with current ratio an acceptable value depends largely on the industry, this ratio provides a better measure of overall liquidity only when a firm's inventory cannot be easily converted in to cash. Inventories were typically the least liquid of firms current assets, thus they were the assets on which losses are most likely to occur in the event of liquidation. Therefore, a measure of firm's ability to pay off short-term obligation without relying on the sale of inventory is important.

From general over view of the above note it was seen that the quick ratio of the firm was similar to the general standard, this means effectively monitor or able to continue its operations to focusing on maintaining efficient levels of both components of working capital, current assets, and current liabilities, in respect to each other. And this implies the company can be able to pay off its creditors in time due to larger proportion of stock in current assets. On the other hand there was a large part of current asset of the firm which is tied up in slow-moving and unsaleable inventories.

4.6. Profitability and risk trade off

The effect of changing the levels of the company's current assets on its profitability and risk trade off can be demonstrated by using the ratio of current assets (CA) to total asset (TA)

Table-7 Ratio of CA to TA

Year	2010	2009	2008	2007	2006
CA	85,420,089.6	86,736,663.3	112,321,115.3	77,210,747.0	39,480,147.3
	4	2	6	3	7
TA	196,672,533	208,249,246	153,389,295	120,326,257	76,721,644.8
CA/T A	0.43	0.41	0.73	0.64	0.51

Source: Balance sheet of EBSC from (2006-2010)

As above table 7 indicates, the ratio of current asset to total asset was increasing the first three years and the remains two years were declining via out the given trend. This shows the amount of fixed asset of the firm has been declining throughout the period; therefore, the profitability of the company has been also declining relatively in the years 2009 & 2010. This is mainly due to fixed asset was more profitable than current asset in the earliest years, whenever, the current asset increases while the fixed asset decreases or remain a constant. Then, CA to TA ratio increases, but profitability decreases. As above result shows, the amount of fixed asset of the firm was good and this implies that the company become profitable, due to current asset less profitable than fixed assets that contributes a lot to generate revenue.

Table-8. Ratio of current liability (CL) to total asset (TA)

Year	2010	2009	2008	2007	2006
CL	5,388,303.44	8,195,702.64	5,144,278.51	2,993,157.83	2,519,407.74
TA	96,545,532.6	207,889,246	153,389,295	77,828,140.7	76,721,644.8
CL/TA	0.055	0.039	0.033	0.038	0.032

Source: Balance sheet of EBSC from year (2006-2010)

Based on the above table 8 the effect of changing the level of factory's current liabilities on its profitability and risk trade off can be demonstrated. When the ratio of current liability to total

asset decrease the profitability and risk are also decrease. The ratio of CL to TA of the company which was under study was increasing from year to year from 2006 – 2010 so, the profitability and risk trade off also increase in the same manner which means the company increase the profitability and risk also high, this was because the firm was used more of less expensive current liabilities and short-term financing.

4.7 Cash Management

A company needs cash to carry day to day activities of the business. Company’s level of operation affects working capital requirement, it affects the need for cash.

Table-9 Cash and Sale figures

Source: Balance sheet and Income statement of (2002-2004)

Year	2010	2009	2008	2007	2006
Cash balance	29,717,706.88	15,067,022.46	15,318,897.52	33,281,866.81	13,903,906.54
Total sale	198,033,627,34	148,661,925.62	133,743,796.53	125,340,664.46	38,849,677.20

If the volume of sale increase, cash had been received from customers and expanded capacity to produce the products, as shown in the table 9 above the sale from year 2006 – 2010 has been increasing to cover the transaction needs. Therefore, the company’s ability to pay its bills would have been increasing meaning the company improving its cash management from the year 2006 – 2010.

From the above table the amount of cash balance increases from year to year that was from 2006 – 2010. Based on this it was simply to conclude that as a result of increase in sale from year to year and increase in cash balance from year to year the company has used moderate cash management.

4.8 Receivables Management

Receivables were asset accounts representing amount owed to the company as a result of the sale of goods and service in the ordinary course of business. If the business firm has not been

able to collect its debtors or receivables within was a salable time. For this reason, its funds are unnecessarily locked up in receivables. The following were ratios used for meaning the liquidity of the company's account receivables (A/R)

$$\text{Account receivable Turnover} = \frac{\text{Credit sale}}{\text{Average A/R}}$$

$$\text{Average account} = \frac{\text{Beginning balance} + \text{Ending balance receivable}}{2}$$

2 Table -10 Receivable turn over

Year	2010	2009	2008	2007	2006
Credit sale	65,351,097.0	99,437,152.1	64,698,156.1	125,340,644.4	38,849,677.2
Average A/rec	14,571,904.4	9,009,916.4	10,270,050.2	8,487,039.55	3,159,235.76
A/rec turn over	4.49	11.03	6.3	14.8	12.3

Source: Balance sheet and I/statement of (2006-2010)

The receivables turnover ratio was the comparison of the size of the company's sale and size of uncollected bills from customers. If the company having difficult in collecting its money, there had been large receivables balance but has low turnover ratios. To show the accurate picture of turnover ratio of company, the average receivables are taken in the above table 10

The receivable turn over in the year 2007 is more rapid than others. Even though, the company increases receivable turn over from year to year to take advantage of strict collection policy, there may be losing of future sale due to high pressure collection policy or techniques. This in return results in the shift of customers to another firm, because payment in a short period of time is difficult when it compared with more extended time. As the loss of future sale increases, then, the firm have become unjustifiable of economy.

The most measure for liquidity of receivables was average collection period (ACP) which compares the receivable balance with daily sales requirement.

$$\text{Average collection} = \frac{\text{Account receivable}}{\text{Total Sale}} \times 365 \text{ days period}$$

Table-11 Average collection period

Year	2010	2009	2008	2007	2006
A/re c	20,018,985.7 2	9,124,823.13	8,895,009.7	11,645,090.69	5,328,988.4
Total sales	65,351,097.0 2	99,437,152.1 3	64,698,156.1 9	125,340,644.4 6	38,849,677. 2
ACP	112 days	34days	50days	34days	50days

Source: Balance sheet and Income statement (2006-2010)

The shorter the average collection period, was the better quality of debtors from the above table 11, researcher was clued that company used best collection period in year 2007&2009 as compare to others.

The decrease in average collection period in year 2007&2009 was resulted from receivable managing activity of the firm. That was the company has been improving the management of receivables for successive years.

4.9 Inventory Management

The management of inventory has an impact of the cash cycle of the company. Poor inventory management will results in an illiquid company that must continually borrow in order to have enough operating cash on hand. Inventory turnover ratio measures how quickly the inventory were sold. It was the test of efficient inventory managements.

$$\text{Inventory turnover} = \frac{\text{Cost of goods sold (CGs)}}{\text{Average inventory (Average, Inventory)}}$$

$$\text{Avg. Inventory} = \frac{\text{Beginning balance} + \text{Ending balance}}{2}$$

Table-12 Inventory turnover ratio

Year	2010	2009	2008	2007	2006
CGs	169,915,418. 01	197,100,223. 14	98,735,637.1 7	95,992,390. 1	30,518,149.0 2
AV. INV	49,016,914	61,742,454	60,086,163.5	25,799,446	9,810,952.2
Inv.	3.5	3.2	1.7	3.7	3.1

Turnover ratio					
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Source: Balance sheet and I/statement of year (2006-2010).

Low ratio of inventory turnover shows that the company is incurring high costs from over stocking finished goods at the same time the company was carrying obsolete goods in its inventory. In the above table 12 the company was on the way of improving its inventory turnover ratio by increasing most of year to year. It shows the company's incurring cost was been reduced, but is not saying that the enterprise become effective in inventory management. Still it is in the position of inadequate inventory management due to over holding of stock in the store. So as to see specifically for how much time inventories were converted in to cash or account receivable was shown in the table below.

Table-13 Inventory conversion period (ICP)

Year	2010	2009	2008	2007	2006
Days	365	365	365	365	365
Inventory turn over	3.5	3.2	1.7	3.7	3.1
ICP	105 days	114days	215 days	97days	118days

Source: Inventory conversion formula and Inv. To take from table 12

$$\text{Inventory conversion} = \frac{365 \text{ days}}{\text{Inventory turnover}}$$

Although the inventory conversion period decreases from year to year accordingly, it takes more than one year to convert it in to cash. The over Stocking of inventory for long period of time indicates that the presence of unresolved conflict between the marketing and finance function. In other cases the marketing depart has responsibility to facilitate the inventory to be converted in to cash, therefore there was weak side of it. And finally the company's position of inventory management was not good.

CHAPTER FIVE

Conclusion and Recommendation

5. Introduction

This chapter presents conclusions drawn from the overall overviews of the research by adding the main findings of the analysis part and give recommendations based on findings to improve the working capital of Eden business Share Company.

5.1, Summary of findings

A, Working capital issue

The company operated a formal working capital policy representing 66.7% of the respondents. The responsibility of setting the policy of working capital largely rest with the managing director representing 55.6% of the responding in respect of working capital management in the past were poor as compared with the current WCM.

B, Liquidity measures

The liquidity position of the firm was shown using different liquidity ratios which are useful to judge a company's ability to meet short-term obligations. The following basic liquidity measures are used to compare financial position of Eden Business Share Company for past five year's balance sheet if used as source of data.

✓ Net working Capital

Net working capital is one of the most commonly cited financial ratios to meet firm's short-term obligation, which is denoted as current assets minus current liabilities and it expresses the difference between the two. Networking capital = current asset – Current liability.

✓ Current Ratio

Current ratio is one of the most commonly cited financial ratios to meet the firm's short-term obligations when and as they fall due or at maturity. It expresses the relationship between the firm's current assets to current liability.

$$\text{Current ratio} = \frac{\text{Current asset}}{\text{Current liability}}$$

✓ **Quick Ratio**

This ratio is somewhat more accurate guide to liquidity and it was the same as current ratio except that it excludes inventory which was least liquid asset. (Financial management I.M Pandey, 2005)

✓ **Cash Management**

A company needs cash to carry day to day activities of the business. Company's level of operation affects working capital requirement, it affects the need for cash.

✓ **Receivables Management**

Receivables are asset accounts representing amount owed to the company as a result of the sale of goods and service in the ordinary course of business. If the business firm has not been able to collect its debtors or receivables within is a salable time. For this reason, its funds are unnecessarily locked up in receivables.

✓ **Inventory Management**

The management of inventory has an impact of the cash cycle of the company. Poor inventory management will results in an illiquid company that must continually borrow in order to have enough operating cash on hand. Inventory turnover ratio measures how quickly the inventory is sold. It is the test of efficient inventory managements.

5.2 Conclusion

As stated by Siddiquee and Khan (2009) it has been observed that, firms which were better at managing working capital were found to be able to build a better competitive advantage and efficient level of working capital should be present for smooth running of business regardless of the nature of business.

Eden business Share Company was manufacturing enterprise which aims to maximize its profit. So as to achieve such objective, management of working capital was very important. The general objective of this study was trend analysis on working capital management in case of Eden business Share Company and in the scope of this study, the researcher has used for five years (2006-2010) financial statements.

In this study the researcher has been used mixed research approach, descriptive research design, primary and secondary source of data, probability sampling techniques the data was

analyzed through descriptive method. In descriptive method, the study result comply in the form of table, percentage, ratio method to describe working capital management in Eden business Share Company.

In the questionnaire part participation of the respondents were two females and seven males, most of the respondents are degree holder and have less than five years work experience. As one can understand about working capital requirement all of the respondents respond that the working capital requirement of the company is highest during operation efficiency.

Liquidity position of the company was shown using different liquidity ratios which were useful to judge a company's ability to meet short-term obligations, those are net working capital, current ratio, and quick ratio. The result of overall liquidity ratio analysis also reveals the fact that almost all of the ratios calculated show the deteriorating trend over the past five years and from these and other facts it can be said that the working capital management of company over past five years was good.

The other aspects of changing the levels of the company's current assets on its profitability and risk trade off can be demonstrated by using the ratio of current assets (CA) to total asset (TA), as the result shows, the amount of fixed asset of the firm was good and this implies that the company become profitable and the company cash was increase from year to year. If the company having difficult in collecting its money, there had been large receivables balance but has low turnover ratios and low ratio of inventory turnover shows that the company was incurring high costs from over stocking finished goods at the same time the company was carrying obsolete goods in its inventory.

It was known that proper working capital management used to company to achieve adequate liquidity and the factory have sufficient cash to pay its bills when they come due because of stocking inventory for short period and liabilities among current account was task of minimizing the risk of insolvency and increases the profitability of the company.

5.3 Recommendations

The findings of this study were helpful for financial managers of the manufacturing companies and it provide the information was useful for maintaining a healthy competition and improving own organization.

The researcher based on the above findings and conclusions drawn, recommends to the managers, employee and others of the Eden business share company.

- The working capital management policy need to be formal to enhance the chances of the company to be successful in their WCM. Further, the policies of working capital had been reviewed more than once a year depending up on the company so that weaknesses can be identified early for redial action to be taken on time.
- If there was cash deficit how does the company overcome (finance) used to the short term borrowing was obtained for a period, less than one year. It was arranged in advance from banks and other suppliers of short –term finance in the money market. Short-term finance include working capital funds from banks, public deposits, commercial paper, factoring of receivable etc.
- Current ratio and quick ratios of the company were not enough. So, the company should increase its current asset over current liability and decrease the amount of stock to meet its current obligation and to its run business in future.
- The company takes more than one year to convert inventory or over stoking (keeping unnecessary inventory in store). This results in shortage of cash. Therefore, the company should minimize over stock to maintain the balance of cash needed for transactions, besides to meet its current liabilities when comes due.
- Credit policy of the company has been improving in trend, more or less the company is in position of following strict collection policy. This results in the loose of customers, because the shorter collection period is more difficult to pay who compared it with more extended collection period. Therefore the company should consider both its customers and bad debt of receivables if the time was extended. So, the company should use moderate credit policy.
- In general, should use an acceptable strategy to manage its working capital.

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- The company should minimize over stock to mainta

APPENDIX I
QUESTIONNAIRE
WOLKITE UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

Dear respondents

I, Biruk Sisay currently working a research entitled trend analysis on working capital management. The purpose of the study was for partial fulfillment of the requirement of BA degree in accounting and finance. This research project was to assess the trend analysis of working capital management in Eden business Share Company. The information you provide had been used only for the purpose of the study and will be kept strictly confidential with the researcher. Therefore for the successful accomplishment of the study your response have been pivotal role by being used as valuable input for the study.

There were no need to write your name. Please indicate your answer with “☒” make and write important information when it was needed. The researcher would like to thank in advance for your valuable information.

Background of the respondent

1. Age: A.18-25 B.26-40 C.41-60

2. Sex: A. Male B. Female

3, Educational level: A, diploma B, degree C. master degree D, PhD

4, Work experience: A, less than 5 years B, between 6-10 years C, greater than 10 years

5, Job position? A, manager, B, vice manager c, employee

6. Year of establishment of Eden manufacturing company?

Research related questions

7, what are the main raw materials of the Factory? -----

8. From where does the factory get them? -----

9, How do you control your working capital?

A. Using working capital ratio analysis

B. Using cash operating cycle

C. Just on time system

D. Other, specify -----

10, Do you reserve a desired minimum cash balance?

A, Yes

B. No

11. If there is cash deficit how does the factory overcome (finance) it?

A. Short term borrowing

B .Use trade credit

C .Other, specify -----

12. What is the maximum time required for inventory to be stayed in store?

.....
.....
.....

13, What method of promotion the company is utilizing to create awareness?

A, -----

B, -----

C, -----

14, what problem do you face in your investment activity currently?

A, financial related

B. market related

C, others if any

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.....

15, who sets the management policy for working capital for your company?

A, Board of directors

B, President (CEO/M.D)

C, Vice president

16, when the Eden business share company working capital requirement reach maximum?

A, during inflation B. during growth

C. during operating efficiency

17. Does the company face with liquidity problems so far (risk of unable to pay short term obligation)

A. Yes B. No

18. Does the Eden business share company offer credit sales?

A. Yes B. No

19. Does the company offer discount period?

A, Yes B, No

20. If the answer is yes for question number “20” what is the role of allowing discount period?

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.....
.....

21. Is Eden business Share Company profitable?

A, Yes B. No

22. Loan size related to your business?

A, short term

B, long term

C, middle term

23. Does your company have an overall policy for the management of its working capital?

A, Formal policy

B, Informal policy

C, No policy

