POST RESTRUCTURING ANALYSIS OF WORKING CAPITAL MAMNAGEMNET OF POKUPHARMA LIMITED

By

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DECLARATION

I hereby declare that this submission is my own work towards the Master of Business Administration (Finance Option) and that, to the best of my knowledge, it contains no material previously published by another person nor material which has been accepted for the award of any other degree of the University, except where due acknowledgement has been made in this text.

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ABSTRACT

Since its establishment in 1995, the operations Pokupharma Limited has been centred on the provision of quality and affordable medicines to keep the people of Ghana healthy and provide people in poor health with medicines to get them healthy. The company did this for the first thirteen years through simple buy-and-sell. However, since 2011 the company restructured and started manufacturing of pharmaceutical products.

Nonetheless, there has not been any documented work on the working capital management since the restructuring. Moreover, the restructuring of the company has brought about changes in the components of working capital and this is an area of important concern to the management of the company. The purpose of the study is to fill this research gap in working capital management and the recommendations will also help management to enhance the fortunes of the company. Though the scope of the study extends beyond six years, the analysis of the financial statement was limited to a six-year period spanning from FY2008 to FY2013. The study revealed that the company‟s working capital cycle has continuously been negative since FY2010. The company‟s liquidity position was found to unsatisfactory because of the poor management of cash and other current assets. The large amount of investment in inventories with no immediate use has also affected the profitability of the company.

On this note the study recommended that regular measurement of working capital, for quick identification of the trend and any looming liquidity problems that require immediate redress. All idle funds with no immediate use should be put into productive investments. Also, periodical physical review of the inventory needs to be conducted to ensure reduction in inventory carrying costs of slow-moving or obsolete items to improve cash flow.

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To the staff and management of Pokupharma Limited, siblings and friends who assisted me in diverse ways during the research; I want to say that I am grateful.

May God shower his blessings on you all.

DEDICATION

This thesis is dedicated to all the special people in my life.

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INTRODUCTION

1.0 Background of the study

Small and medium Enterprises (SMEs) constitute large proportion of global businesses. International Finance Corporation (IFC, 2012) reported that about 90 percent of businesses around the world are SMEs. Over half of the world employed population is found in SMEs. The figure is even high in advanced economies with an estimate of 65 percent of the total employment being SMEs. It is therefore not surprising that over 55 percent of the gross domestic product in these developed countries is coming from the contribution of SMEs. According to the
US Census Bureau data in 2011, 99.7 percent of the 5.68 million employer firms in the United States, the largest economy in the world, were firms with less than 500 employees. Whiles businesses that employed less than 20 employees accounted for 89.8 percent of the less than 500 employee firms. Data from European Observatory (ENSR, 1997), SMEs with not more than 250 employees constituted 68 million of the European Union jobs in 1995.

The significant contribution of SMEs to the growth of an economy and employment creation has been the reason for describing SMEs as the main engine for productive growth and job creation across the world, especially in developing countries. Havie et al. (2011, p. v) in a summary wrote, "SMEs and entrepreneurship are widely recognized as being the key sources of dynamism, innovation, and flexibility in advanced industrialized, emerging markets and developing economies, and a major net job creators in these economies". The statement highlights the critical role such businesses play strengthening macroeconomic fundamentals of countries around the world.

A vibrant and productive SMEs is what most developing economies requires if it is to close in the gap between themselves and the developed economies, particularly in Africa. SMEs are recognized by many empirical studies to be the backbone of growth. SMEs in African country like Tanzania is reported to contribute to more than 33 percent of the country‟s GDP. In South Africa the portion of GDP resulting from the operations of SMEs is estimated to be between 52 and 57 percent. In 2003, SMEs in Kenya accounted for 18 percent of GDP, employing 3.2 million workers in the process. In Ghana‟s case the estimated contribution of SMEs is over 70 percent while at the same time constituting about 92 percent of businesses in the country. SMEs in Ghana also provide employment for over 85 percent of the labour force employed in the manufacturing sector whereas the percentage is 70 in Nigeria accounting for 95 percent of formal manufacturing activity (Frimpong, 2013; OECD, 2005). The United Nations Industrial Development Organization (UNIDO) estimates more than 90% of all registered businesses in Africa are SMEs.

The myriad of benefits associated with vibrant SMEs has not been fully utilized by many developing countries, especially in Africa. A number of factors can be cited for this phenomenon but overriding factors are obstacles in accessing business finance and poor financial management. The major sources of the finance for SMES has been retained earnings, informal savings and short term loans which are usually unreliable. Lenders often perceive SMEs as risky and therefore are less willing to extend credit to them. The high mortality rate, suspect managerial capabilities, vague financial records and business proposals among others have not really help the case of SMEs in securing credit facilities. The difficulties that SMEs in the Ghana face in assessing finance have impeded their emergence and eventual growth (Aryeetey et al., 1994). Small and Medium Enterprises demonstrate considerable gaps in information and abilities that are necessary in seeking external fund, particularly in developing economies.

The problems that lead to the failure of SMEs to survive and succeed are not limited to lack of access to finance but also poor working capital management practice and financial management in general. For SMEs, working capital management plays a vital part in circumventing financial holdups given that there is inadequate supply of external funds. Cash management, inventories, and accounts receivable and payable form the component of working capital management. The components are interrelated to one another. The interrelationship of the working capital processes means decisions that affect each component will consequently impinge on the other processes and ultimately affect the overall financial performance of the SMEs.

Although some have described SMEs as the core of the private sector, the rate at which SMEs folds up is quite alarming. This has been attributed to a number of factors but chief among these factors is the challenge with acquiring finance assistance and the management of working capital of the small and medium businesses.

The inability small and medium sized businesses to source external funding stems from the fact that many of the lending institutions like the banks for example have their doubts about the prospects of the business and asymmetric information problems. This is the result of how these businesses present and market themselves as well as poor experiences with some businesses in the past. SMEs often present vague and poorly prepared business plan and strategy if any to instructions for assistance. The lending institutions are also in business to money from the payment of interest and the eventual repayment of the principal, for this reason they are more reluctant to provide finance for businesses they are not sure of.

The management of working capital has also been very poor among a chunk of SMEs. This has affected the profitability of most SMEs. A survey in Ghana has revealed that majority of SMEs managers put little emphasis on formal financial records keeping. Two main reasons were cited for these phenomena are: First, the managers are not under any obligation to keep records of their financial activities. The second reason was the fear that keeping records of their financial activities will lead to the disclosure of the business earnings. And this will give the revenue collection authorities grounds to come after them. The situation is not any different from that of Uganda, where owner mangers relies mostly on informal keeping of business records. Others also rely on the memories of managers to track account receivable and inventory (Mazzarol, 2014).

More often than not, WCM in SMEs is far from optimum level in developing countries. This is usually due to lack of expertise in the management of working capital. Mazzarol (2014) pointed out that the key to achieving a more efficient financial management skills among SME ownermanagers‟ is education. Business manager with financial knowledge and understanding of financial statements make use of their knowledge in their decision making and are better positioned financially than their counterpart without good financial understanding.

There is the need for business, especially Small and Medium Enterprises (SMEs), to reduce cost, minimize the need to borrow and create value in their operations through increased operating efficiency and working capital optimization. To achieve efficient working capital, it is essential for SMEs to utilized suitable technique and procedures in reviewing and analyzing working capital management (WCM) of the business together with efficient use of liquidity. With SMEs highly exposed to the risk of insolvency, efficient management of finance is very crucial if the business is to survive and succeed. By efficiently managing working capital the business will be able to free up tired up liquidity of the business for efficient utilization to enhance profitability. In spite of the enormous and increasing roles of SMEs for the Ghanaian economy and their widespread financial challenges, not much attention has been paid to the financial management of SMEs. Though financial management in SMEs and large companies has strong similarities; there is a significant difference which substantiates the study of financial management in SMEs. Since SMEs experience difficulties in accessing external funds, they rely heavily on internally generated funds. Therefore working capital management plays a very important role in financing SMEs. This assumption is confirmed by the fact that working capital related problems are cited among the most significant reasons for the failure of SMEs. Working capital management is related to short-term financial planning and cash level which broadly represents a significant indicator for short-term performance.

As the firm‟s current liabilities continues to remain below the level of its current assets, the firm will continue to be liquid depending on the characteristics of the firms current assets. Although many of the insolvency of businesses has been attributed to poor management of working capital, many firms in the world continues to neglect the management of such as important aspect of their business (Smith 1980).

Due to the ineffectiveness of most firms in managing working capital (Atrill, 2006), it is necessary to pay more attention to working capital management. This calls for assessment and coming out with suitable ways in the effectual management of working capital to derive the benefits of being competitive in today‟s world of business as well as for the long term survival and success of businesses.

1.1 Problem statement

Pokupharma Limited has been a nationwide distributor of pharmaceutical products in Ghana since its establishment in 1998. From that time, the company has continuously achieved a positive growth in customer base. Due to the growing Ghanaian population and the state of healthcare system in the country, more people continue to demand medicine. Furthermore, majority of the workforce in Ghana are engaged in manual and menial jobs which demands a lot of energy and can easily make the workers tired, weak or sick. This has created a dynamic and growing market for pharmaceutical product providers, which Pokupharma Limited is part of.

In 2011 the company restructured and as part of the company‟s plans to expand, remain competitive and hold on to its market share in the pharmaceutical industry in Ghana, the company started the production of pharmaceutical products, mainly oral medications. The restructure and expansion has brought about structural changes with significant difference in the company‟s operations and finances.

Nonetheless, there has not been any documented work on the working capital management since the restructuring. Moreover, the restructuring of the company has brought about changes in the components of working capital and this is an area of important concern to the management of the company. The purpose of the study is to fill this research gap in working capital management and the recommendations will also help management to enhance the fortunes of the company.

1.2 Objectives of the study

The main objective of the study is to analyze the post restructuring working capital management of Pokupharma Limited. Specifically, the study seeks:

- To examine the sources of finance for Pokupharma Limited.
- To explore the cost effectiveness of inventory management of Pokupharma Limited.
- To examine the trends in the components of working capital of Pokupharma Limited.
- To analyze factors that promotes or inhibits successful working capital management of Pokupharma Limited.

1.3 Research Questions

The study would seek to find answers to the following research questions:

- What are the sources of finance for Pokupharma Limited?
- How cost effective is inventory management of Pokupharma Limited?
- What are the trends in the components of working capital of Pokupharma Limited?
- What factors that promotes or inhibits successful working capital management of Pokupharma Limited?

1.4 Justification for the study.

The small and medium enterprise sector is an essential player in the generation and promotion of economic activities in an economy. The relatively small capital requirements and labour intensive nature are some of the unique features of the sector. In fact, the sector has a major role to play in developing nations which suffer due to low capital formation.

Despite their vital role, the SMEs in Ghana have not been performing as much as expected in contributing to the national revenue budget. This has been ascribed to the different problems faced by SMEs at the promotional and operating stages which are consequences of working capital management problems. Proper working capital management is to ensure that the right amount of money and line of credit are available to the business at all times.

Cash is the life-blood of any business no matter how large or small. If a business has no cash and there are no ways of getting any cash, it will go out of business. Similarly, a business could be in serious financial trouble if it has no idea of its cash level and working capital position.

Global economic and financial factors consequently are increasing the competitiveness of the global market. This is making it difficult for inefficiently run businesses to survive. Poor working capital management is one of the global economic factors causing businesses to wind up, especially among the SMEs. Today‟s world of business seemed to have overlooked this concern. It is against this backdrop that this research is being carried out to:

- assist management of Pokupharma Limited in identifying efficient ways in the management of the company‟s working capital.
- serve as a guide to policy makers in the corporate world who face problems in their working capital management.
- contribute to the knowledge in the field related.
- fulfill the requirements for the award of the MBA degree at KNUST School of business.

1.5 Research Design

The study employs both primary and secondary data in its analysis. Primary data are mainly information collected from the company by the researcher through interviews. While the secondary data set was drawn from the audited Financial Statement of the company; Statement of Financial Position (Balance Sheet), Income Statement (Profit and Loss Statement) and Statement of Cash Flow. These together with other monthly and quarterly financial and management reports form the main source of data for the study.

1.6 Scope of the Study

The study has been undertaken to cover the company of Pokupharma Limited in Fumesua, Kumasi. Though the scope of the study is eight years (from 2007 to 2014), the analysis of the financial statement was limited to a six-year period spanning from FY2008 to FY2013. The choice of the study period is dependent on data availability. The study focuses on the key components of working capital which comprises cash, inventory, accounts receivables and payables and their impact on working capital management of the company.

1.7 Organization of the Study

The research is organized into five chapters:

The first chapter focuses on general introduction and background of the study, problem statement, study objectives, methodology, organization of the research and limitations to the study.

The second chapter deals with literature review which involves the theoretical frame work of the study. This gives a general understanding and in-depth knowledge of working capital management processes and concepts from different publications such as text books, articles, magazines, technical papers and journals. It takes into consideration some of the empirical works of other researchers that are relevant to the study.

The third chapter presents the research methodology used in gathering data for the study. It describes and justifies the methodological approach which has been used to collect and analyses the data for the research.

The fourth chapter presents data, analyses and discusses the estimation of the results to know the effectiveness of working capital management in Pokupharma Limited. The analysis is carried out through ratio analysis and also through the analysis of interviews.

The fifth chapter concludes the study, and deals with the issue of whether the aim and purposes of the work has been fulfilled on this basis. The chapter also suggests recommendations on the subject under investigation for consideration.

1.8 Limitation of the study

There are some important limitations with this study which include:

The academic schedule in which the study was conducted was not favorable for easy completion. The financial statements comprise only historical data and would not necessarily be a reflection of the future.

In financial accounting it is challenging to account for changes in the level of prices.

The reliability and accuracy of the calculations and interpretation is dependent on the supplied accounting information in the form of annual reports and other records.

These collectively affected the research work. However, these limitations did not affect the quality of the study.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

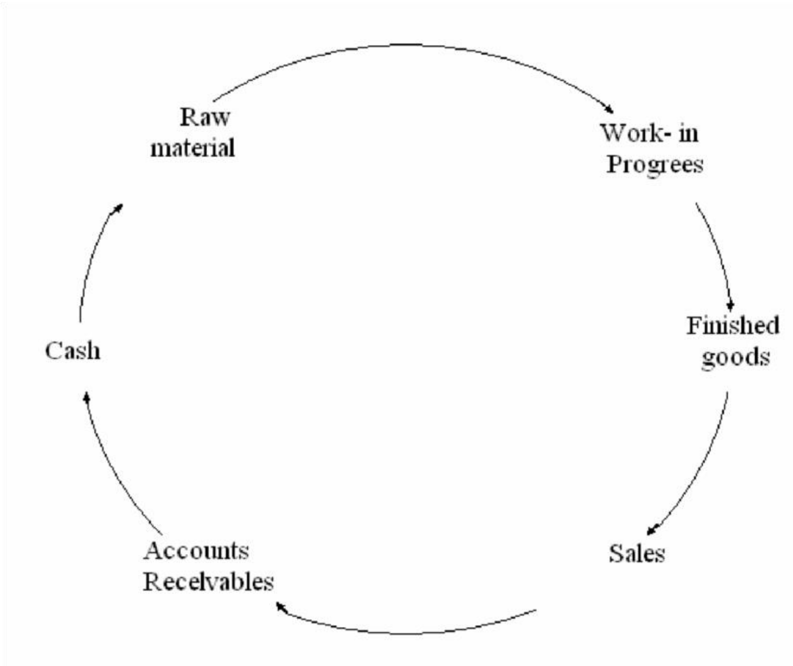
This chapter briefly reviews some of the literature of the works by other researchers relating to working capital management.

2.1 Conceptual Framework of the Study

Working Capital also called net working capital according to Watson and Anthony (2007), is the difference between a firm's current assets and liabilities. The term working capital, in this context, denotes the part of business capital readily available to finance the recurring costs of operations of an organization. It is the difference between the resources in cash in addition to current assets that can be converted into cash and the firm‟s liabilities for which cash will shortly be needed (current liabilities). This difference, often referred to as Net Working Capital, is a qualitative concept, which specifies; the liquidity of an organization and the degree to which permanent and long term sources of funds will be used in financing working capital requirements.

It is therefore important for organizations to maintain an optimum balance of each of the working capital components to ensure a continuous flow of cash into the business (Gamble. R. 2003). This critical role is portrayed in Figure 2.1 below, which is often called “working capital cycle”.

Figure 2.1: Working Capital Cycle.



Source: Mathur (2013)

2.2 Financial Ratio Analysis

A financial ratio, as defined by Groppelli et al, (2000), is a ratio of two selected numerical value taken from the financial statements of a business entity. A plethora of standard ratios exist for the evaluation and determination of the general financial condition of a business. The users of financial ratios include management within a business and existing and potential shareholders. The creditors may also be concerned with financial ratio to be assured of repayment capabilities of the business. Customers may also use is in be sure of continues supply of the goods and services provided by the business as and when they demand it.

Financial statement is the main source of values used in calculating financial ratios. The financial statement encompasses of the statement of financial position (balance sheet), income statement

(Profit and Loss), cash flow statement and less frequently statement of retained earnings. Ratio may be expressed in terms of decimals (0.05) or percentage (5%). Often a number of ratios are written in percentages terms, more especially the ones that are always less than 1, whereas others are that are usually more than 1 are written in decimal numbers.

Financial ratios enumerate many facets of a business and forms fundamental part of financial statement analysis. The categorization financial ratios are in accordance with to the financial part of the business which the ratio measures. For instance, the availability of cash to settle debt obligations is measured liquidity ratios but activity ratios measure swiftness of the transformation of a business‟ non-cash assets into cash assets. The measurement of the business‟ assets usage and expenditure control to generate a satisfactory rate of return is captured in profitability ratios. The measurement of how investors‟ reaction to owning a company‟s stock and the stock issuance cost are captured in market ratios. Financial ratios allow for comparisons; between companies, between industries, between different time periods for one company as well as between a single company and its industry average.

Williams et al, (2008) stipulate that "The ratios of firms in different industries, which face different risks, capital requirement and competition, are not comparable. Financial ratios are based in summarized data presented in financial statements. This summarized data is based on the accounting method and standards used by the organization."

2.2.1 Various Types of Ratios

Ratios are effective tools in the analyses, computation and interpretation of financial and accounting data and information. Ratios are categorized into groups that are connected to the area of concern. There are a large range of ratios in each category. Different authors, however, prefer different names. The following ratios are normally linked to WCM;

- Profitability ratios: return on capital employed, net profit margin, net asset turnover and gross profit margin.
- Liquidity ratios: current ratio and quick ratio.
- Efficiency or Activity ratios: debtor days, creditor days and stock turnover.

2.2.2 Profitability Ratios

The effectiveness of the firm"s in asset employment and expense control in the generation of a satisfactory rate of return is measured by profitability ratios. According to Watson et al, (2007), profitability ratios are a parameter for assessing the management"s success in profit generation. The following are some of the common profitability ratios;

Return on Capital Employed:

Return on capital employed is commonly called the primary ratio. It determines how much a firm has been able to generate out of it capital employed. The ratio is calculated as follows:

$$\textbf{Return on Capital Employed (ROCE)} = \frac{\textbf{Profit before Interest and Tax}}{\textbf{Capital Employed}} \times 100$$

Return on capital employed represents the relationship between the company"s overall profitability to the finance employed in its generation. It can also be calculated by the multiplication of net profit margin and asset turnover.

ROCE = Net Profit Margin X Asset Turnover

Net Profit Margin:

Operating profit margin is another term for net profit margin. Capital employed in the formula of net profit margin can be unclear (Watson et al., 2007). However, in simple terms capital employed can either be long term liabilities in addition to the funds of shareholders or the total asset minus the short-term liabilities. Net profit margin can be expressed as:

$$\textbf{Net Profit Margin} = \frac{\textbf{Profit before Interest and Tax}}{\textbf{Sales}} \times 100$$

The calculated ratio measures the effective control of cost in the generation of profit through sales. ROCE is usually positively related to the net profit margin; a rise in ROCE is likely to result in a rise in net profit margin.

Gross Profit Margin:

Gross profit margin is a representation of production cost control as against the cost of distribution and administration. It is calculated as follows:

$$\textbf{Gross Profit Margin} = \frac{\textbf{Gross Profit}}{\textbf{Sales}} \times 100$$

According to Williams et al (2008), dividing the result obtained from the subtraction of cost of goods sold from net sales by net sales also gives gross profit margin.

2.2.3 Liquidity Ratios

Liquidity ratios measure the cash availability for the settlement debt obligations.

This category includes the following ratios:

Current Ratio:

The current ratio relates the firm"s current assets to its short-term liabilities. The calculated ratio represents by how much the firm current assets can be used to pay off its current liabilities when they are due. The ratio is calculated as follows:

$$\textbf{Current Ratio} = \frac{\textbf{Current Assets}}{\textbf{Current Liabilities}}$$

Although the average of each industry may differ, the ratio of two-to-one is seen as satisfactory. It is worth pointing out that, the average of the industry provides a better guide.

Quick Ratio:

The argument against current ratio as a measure of the firm"s liquidity is that, the inclusion of stocks as part of the current asset overstates the firm"s ability in meeting its obligations financially. Hence, the need for quick ratio. Quick ratio resolves this overstatement by taking stocks out of the current assets. The ratio is expressed as follows:

$$\textbf{Quick Ratio} = \frac{\textbf{Current Assets - Stock}}{\textbf{Current Liabilities}}$$

A quick ratio of one-is-to-one is considered generally appropriate. The industries average is expected to provide a better guide in this case as well.

2.2.4 Efficiency (or Activity) Ratios

Efficiency ratio measures the effective utilization of the firm‟s resources or assets by management. The management of the firm‟s working capital is mostly captured here. The most common among the wide range of efficiency ratios are:

Average Inventory (or Stock) Turnover Period:

The ratio measures the period of time taken to convert inventory of the firm into sales. The inventory in this case includes raw materials, work-in-progress and finished good. Nonetheless, there can be ratios for the separate stock components. The ratio is calculated as follows:

$$\textbf{Stock Turnover} = \frac{\textbf{Stock (Inventories)}}{\textbf{Cost of Sales}} \times 365$$

Low inventory turnover days are an indication of low stock holding cost for the firm. The nature of the business determines the appropriate level of inventories the firm is expected to hold.

Average Debtor Period:

The average debtor period represents the average period it takes to receive payment for goods or services sold on credit to customers. Because of unavailability of information on just credit sales, the sales value is normally used instead. The ratio is calculated as follows:

$$\textbf{Average Debtor Period} = \frac{\textbf{Trade Debtors (Payables)}}{\textbf{Credit Sales}} \times 365$$

To know whether the management of the company is being efficient with the collection, the days have to be compared with the credit period allowed by the company.

Average Creditor Period:

The average creditor days measures the average period it takes the firm to pay back goods or services it purchased on credit from the suppliers. Cost of goods sold is used in place of credit purchases where such data is unavailable. The ratio is expressed as follows:

$$\textbf{Average Creditor Period} = \frac{\textbf{Trade Creditors (Receivables)}}{\textbf{Credit Purchases (Cost of Sales)}} \times 365$$

The calculated average creditor days can be compared with the credit days allowed by the suppliers to know whether the firm is maintaining a good relationship with its suppliers.

Cash Conversion Cycle

Operating cycle or working capital cycle is another name for cash conversion cycle (C.C.C.). C.C.C. is obtained by subtracting average creditor period from the addition of average inventory turnover period and average debtor period. This represents the number of days working capital financing is required.

Cash Conversion Cycle (CCC) = (Average Inventory Turnover Period + Average Debtor Period) - Average Creditor Period.

Short cycle implies lower working capital investment and vice versa.

2.3 The Nature of Working Capital

According to Terry (2008), the management of working capital comprises cash management, inventories, accounts payable, accounts receivable and short-term financing. The interrelationship of the five components of working capital processes means decisions that affect each component will consequently impinge on the other processes and ultimately affect the overall financial performance.

2.3.1 Cash Management:

Cash management, as part of treasury management, is involves the optimization of the available cash, earning the highest possible interest on idle funds as well as minimizing the losses incurred as a result of transmission of funds delays. There is an opportunity cost to holding cash, and it is equal to the return the cash could have generated if it had been put to the next best use. The use of small amount of cash as a way of reducing the opportunity cost consequently increases the risk of the business with respect to fulfilling its debt obligations. It is therefore important for the business to find optimum balance of cash in its operations.

There are several ways of speeding up the collection of credit of funds and the generation of interest income on deposited funds. One of such ways is banking services that are provided to the firm by banks in the form of managing receipt and payment in foreign currencies among others. The firm in return keeps a predetermined minimum balance for the bank to generate return on after lending it out to borrowers. Lockbox system can be use by firms, where customers are instructed to make payments in post-office boxes to be collected and deposited in the bank accounts of the business later by local bank. In recent times, electronic fund transfers can also be used by customers in making swift payments in the accounts of the firm, making cash management process more automated (Brigham and Ehrhardt, 2011). There is also the use of sweep accounts to automatically "sweep" excess funds into an interest-bearing investment such as investing in money market at the end of the day. Common among money market investments are treasury bills, time deposits and certificates of deposit, repurchase agreements, commercial paper and bankers‟ acceptances. It can also use in financing subsidiaries of the business that are in short supply of cash.

2.3.2 Inventory Management:

The term Inventory refers to stock of materials that are use to facilitate production or to satisfy customer demands. Typically inventory is made up of raw materials, work-in-progress and finished goods. Inventory Management on the other hand involves the process of procuring and maintaining an appropriate collection of inventory and at the same time managing cost of ordering, cost of carriage, cost of holding such as rent, insurance, cost of replacing deteriorated and obsolete inventory etc. Economic Order Quantity (EOQ) system and the Just-In-Time (JIT) are the most common inventory system in inventory management. The use of these inventory systems are cost saving techniques employed to avoid interruption in the production and sales process. The EOQ is a classical inventory management system that specifies the optimum size of inventory to be ordered by finding the best balance between holding cost and the ordering cost of new inventories. The EOQ model is used in deriving the minimum cost of total inventory to obtain an optimal size of inventory order. Historical data from customer sales reports together with sales forecasts are used in EOQ inventory system. JIT is another cost saving inventory system, and it is quite popular in recent times due to its effectiveness. JIT is an inventory system that entails having minimum inventories of materials in addition to very prompt and frequent deliveries by suppliers. JIT immunizes the use of inventory as buffer between production stages thereby freeing up capital. This system of inventory requires supplier‟s guarantee of quality and reliable delivery at the required time to avoid disruptions. Other inventory management Systems include ABC Analysis, Enterprise Resource Planning (ERP), Material Requirement Planning (MRP I), Manufacturing

Resource Planning (MRP II), Distribution Resource Planning (DRP) etc. (Lysons and Gillingham, 2003; Coyle et al., 2003).

2.3.3 Accounts Receivable Management:

Receivables or Account receivables refers to revenue that customers, whom have been supplied with goods and services, owe to the business. A large number of business offer credit to their customers as part of the terms of sale. Accounts Receivables Management involves the complete managing of the credit and collection system of the goods or services sold by the business. Businesses offer credit to their customers to be able to sale more and maximize their profit. It is essential to assess the creditworthiness of customers by appraising the financial capabilities, credit history, previous financial problems, payment trends etc. Tauringana and Afrifa (2013) assert that SMEs will be able to perform and function a lot better if they manage the account receivable in such a way to be able to receive payments from the customers within a short period of time. Comprehensive Collection Process (CCP) enhances the cash flow, new markets penetration strengthens, as well as expansion in the number of customer. CCP is dependent on the ease and quick ability to make well-informed credit decisions that provides suitable lines of credit for the business. Swiftness in the conversion of accounts receivables to cash can be achieved if the business implements a good credit management policy in place to comprehensively cover the issues of credit analysis, credit control, trade receivables collection, bad debt insurance and discount for early payments.

2.3.4 Accounts Payable Management:

Accounts Payable Management (APM) is the opposite side of the coin from Account Receivable management. Account payables form an important source of finance for the running of most businesses (Watson and Head, 2010). It is a common practice for businesses to buy goods and services on credit from other firms. Buying on credit allows the business to have access immediate access to the resources and at the defer payment for a while. This debt which constitutes a significant amount of the business" current liabilities is recorded as account payables. The account payables of SMEs are more often high compare to that of large corporations due to the challenges that SMEs faces in accessing financing support from other sources like banks. Efficient management of such an account is very important because it can be as good as any other short-term finance. The account payables management involves the ensuring of policies and practices to deal with goods and services that the business purchases on credit. A good account payables management system is not only an effective ways of saving money for the business but it is also a cost control measure. Negotiation for favourable trade credit and terms of purchase together with prompt fulfillment of credit obligation is vital to the efficient management of this account. A more stable operating cycles and consequently operating cash flow can be achieve if there a good APM in place.

2.3.5 Short-Term Financing:

Short-Term Financing involves securing funds for the operation of the business on short term basis, typically less than one year. The funds from this source are use in current assets financing such as inventories. The main sources of short-term financing are trade credit between companies and bank borrowing (Pandey, 2009). Although all business sizes make use of short term financing, it is of particular importance to SMEs due to the difficulties in securing long term financing. The inability of most SMEs to obtain long term financing is by and large due to their perceived high riskiness. Chiefly among short term financing sources of are trade creditors, customer advances, commercial banks, finance companies, factors, government institutions, accruals, miscellaneous sources (like family, friends, company directors) etc. (Pandey, 2009; Besley and Brigham, 2008). These sources of funds have the merits of being flexible, easy to obtain, no share control, tax savings among others. Frequent maturity and high cost of interest constitute some of the demerits, compared to long term financing.

2.4 EMPIRICAL ANALYSIS

2.4.1 The Management of Working Capital

Businesses best survival skill is their working capital; hence their financial health and long term success are dependent on working capital management. The amount of liquidity in the business is represented by the working capital. Working capital management encompasses a firm‟s current assets financing and management. Working capital management continuously changes in nature therefore; it important for management to decide on the quantity of inventory the firm is capable of holding and means of financing such cost. (Block et al., 2000). In contracts to longterm decisions, there can be no deferral of actions. The ultimate success of the business is the consequence decisions that are long term in nature such as market strategy or decisions on noncurrent assets, however, it is often decisions on working capital which are short term in nature that tell if the business can survive long enough for the long term. While long term decisions can be postponed, the same cannot be said of business related short term decisions.

The management of working capital is of high importance to any business that wishes to succeed. This is because the amount of investment that goes into working capital is usually high when compared to the total assets that the business employs, hence its efficient management is very vital. Nonetheless, SMEs fails give much priority to this important aspect of the business. The management of working capital in most SMEs is totally neglected or handle by personnel with little knowledge in managing it. Evidently, the situation is not any different in Ghana and Uganda where very little attention is paid to financial records by SMEs (Mazzarol, 2014).

With most of the SMEs experiencing undercapitalization, the necessity of efficiently and effectively managing the investment in working capital cannot be overemphasized. Firms should not be confusing making profit with having sufficient working capital. A firm may be making profit and yet it will still be necessary for a firm to borrow as way of supporting its continuous working capital requirements. This is the case if the firm"s profitability is not translating into cash from operations within the same operating cycle.

The challenge for most of the SMEs has been the proper management of their working capital. This is either because the person in charge is not qualified or the business has not recognized the importance working capital management to the ultimate success and survival of the entity. Tauringana and Afrifa (2013) in a study to examine the role education and experience managers play in WCM practices in SMEs. The conclusion of the study was that, the higher the manager"s education level and years of experience in the field of work, the higher the capability of the manager in managing all components of working capital. This will result in best WCM practice in the firm. Agyei-Mensah (2012) also suggested that an experienced and qualified accounts manager brings on board the skill to negotiate for good credit term with vendors as well as customers. In addition such managers are also able introduce the use of computerized financial and accounting software packages to enhance efficiency and performance. Atrill (2006) also maintains that the problems SMEs faces in the efficient and effective management of their inventories is the resulting effect of lack of financial management skills of those in charge.

2.4.2 Efficient Working Capital Management

Efficient working capital management is an essential area of discussion in modern businesses. Howorth and Westhead (2003) advanced the idea that businesses, particularly small scale businesses, are attentive to the aspects of working capital management where marginal returns improvement is expected to be achieved. Efficiency in the working capital management is critical to the success and survival of the business. It is even more important to considering small and growing firms, in terms of profitability and liquidity as pointed out by Peel and Wilson (1996). The study further suggested that small scale business can minimize their risk of going out of business if they are able to adopt formal routines in the management of working capital. These formal routines will help businesses to enhance their performance as well.

The management of cash flow and cash conversion cycle forms an essential part of the general financial management of businesses. However, the importance of these components is more heightened when dealing with businesses that are capital constrained and more dependent on short term finance for the funding of the operations of the business. (Walker and Petty, 1978; Deakins et al., 2001). With these peculiarities, Peel and Wilson (1996) have emphasized the key role that is played by the efficient management of working capital together with good credit management practice on the financial position and performance of the small firm sector.

Similarly, a study by Berry and Marktins (2002) concluded that SMEs can have strong financial position and can perform better if owner-managers are well informed of the importance and benefit that comes with improvement in financial management practices. It was however revealed that generally SMEs have failed in the development of their financial management practices. Whiles Mee (1998) was able to show that more than half of enterprises experience cash flow problems.

Narasimhan and Murty (2001) cited cost control, reduction in working capital investment as well as progress in the efficiency of working capital as a means for a lot of industries to enhance the return on capital employed (ROCE). Shin and Soenen (1998) and Deloof (2003) recommended that small and growing business can increase their profit if they manage to reduce the number of days it takes their debtors to pay them and the inventories levels. This came to light after the studies found a strong significant relationship between the measures of working capital management and corporate profitability.

2.4.3 Working Capital Management for Value

Working capital when efficiently managed creates value for a business. However, looking back at previous reviews on this topic shows little proof on the consequence of managing working capital on firms. Very little is reveals on which factors influence a business‟s management of its working capital. This looks surprising. Yet, these results are due to these reasons. First, nearly every corporate finance book, journal or write-up dedicates some attention and focus to corporate working capital management and issues surrounding it. Also, businesses appear to pay much attention to best they are managing their working capital. A distinctive example is the REL

Consultant Group which conducted a four year annual survey on working capital management performance for CFO Magazine (CFO Magazine, 2005).

The 2005 U.S. survey report suggests that, there is a high positive relationship between a company, how efficiently it manages it working capital, and the returns on the money they invested. These subjects examine the following: what are the results or effects of working capital management for business value, and which factors manipulate a firm‟s working capital management performance. These issues are very crucial or important and this can be illustrated the following examples: IT world (2002) lately posted the results of his study. He argued that inefficient working capital management practices cost IT companies billions of dollars each year.

Making a cross check along this study, it was revealed by REL‟s (2005) Working Capital Survey that, U.S businesses had close to $460 billion caught up in working capital.

Also, Shin and Soenen (1998) said that, in 1994, Wal-mart and Kmart had similar. However, Kmart‟s cash convention cycle was just 61 days whiles that of Wal-Mart were 40 days. Thus Kmart had to spend an extra $198.3 million per year in financing expenses. Obviously Kmart‟s poor working capital contributed to its liquidation.

2.4.4 Investment in Working Capital

Analyzing statistics on a panel of U.S. businesses from 1990 through 2004 reveals a significantly negative relationship between a business‟s value and investment in working capital which is consistent with over-investment in working capital.

This conclusion is not only seen with the above mentioned IT world.com survey, but it is also seen in different annual surveys of U.S. corporate working capital management performance by RRL (2005) Consultancy for CFO Magazine.

Looking at what actually influences a firm‟s working capital management, it was revealed that a firm‟s capital policy is affected by the working capital policies of its industry, its size or expansion rate, expected growth in sales, the number of directors outside company who are on its board, the current CEO‟s remuneration, and its CEO‟s equity shares. As a result, a firm‟s working capital management performance are significant influences by managerial incentives and the monitoring of management.

As emphasized by Shin and Soenen (1998) a business‟s working capital is the result of the time interval between the expenses for the purchase of raw materials and the collection from the sale of finished goods. Thus, this engages many different aspects of a business operational management which is, management of inventories, receivables and management and the use of trade credit and others.

Accordingly, there are a number of research and investigations on individualistic aspects of working capital management (Petersen and Rajan (1997), however, such texts ignore the joint or multiple effect of these individual policies, which is often a crucial part of business distress.

Due to this, the argument is limited to the previous text which focuses on overall working capital management: its causes, effects, and consequences.

2.4.5 Working Capital and Long Term Value Creation

Working capital management is a very essential area which needs critical attention in every business. This is mainly because working capital can help management to drive transparency and accountability throughout the organization. A majority of businesses focus on reducing debtor days and inventory instead of a whole-of-business-approach to working capital. Many organizations are struggling to understand and adapt the cultural and structural changes to enable long term return from working capital reduction. A business which focuses on working capital provides managers the prospects to create permanent value for the business. Working capital is a lens through which management can examine their organization's productivity and efficiency. When implemented or applied correctly, working capital management strengthens the business (Deloitte, 2009).

To improve working capital permanently, businesses must make a cross organizational view of the cash conversion cycle and purchase to pay, forecast to fulfillment and order to cash. They need to break down and inspect the individual components of the entire supply chain and then fix it back together in a way that creates a permanent step change in cash efficiency. This will help businesses to draw take their focus off purely growth oriented procedures which were built when there was an economic boom towards more cash efficient ways of handling things.

2.5 Cash Conversion Cycle and Firm's Profitability

The cash convention cycle described the period a firm or business purchases raw material, converts them into products and services, sell them and realizes cash (Arnold, 1998). As an ongoing liquidity measure developed by Gitman (1974), the cash convention cycle is part of a company‟s operating cycle. Though it is closely linked to the operations cycle, the cash convention cycle is the portion of the operation cycle financed by the business itself

(McLaney,1997). It is calculated by adding both a business‟s inventory period and receivable period and subtracting its account payable from it. It centers on the period between the buying of raw materials and the cash inflows. When the cash convention cycle is shorter, the firm would need fewer resources to secure its business activities and vice-versa.

The traditional approach to the relations between cash conversion cycle and profitability put forward that, longer cash convention cycles have a tendency to lessen profitability. Daily transactions of a firm can be seen as a process in circulation where cash is changed into assets whiles assets are changed into cash. The availability of cash for transactional activities of the business has an important multiplier effect because of its turnover ratio. A higher cash turnover ratio allows firm managers to minimize short-term investments especially those with relatively lower returns as compared to long-term investments which in effect increases profitability. Instead of analyzing the major reasons of the relationships between profitability, liquidity, and working capital management practices, various research on working capital are mostly linked to improving models to decide the optimal liquidity and cash balance.

Baumol (1952) and Miller (1966) earlier presented renowned studies on inventory management model and cash management model respectively. These studies have been recognized as one of the best in this field. Despite the fact that the basics of these models and their underlying assumptions are not well-recognized with respect to their relevance in application, they provide management of businesses with information on the challenges and effect of working capital management practices. Later, Johnson and Aggarwal (1998), equally, also developed a cash management model targeting the cash flows. He pointed out that cash collection and cash payment procedures should be handled individually.

Traditional measures of liquidity lack of expressing the effects of cash flows as mentioned before. Hence, the effectiveness, efficiency and quality of working capital management practices and procedures should be revised by components of cash conversion cycle.

2.6 Measure of Liquidity

2.6.1 Traditional versus Cash Conversion Cycle (CCC)

Generally, finance theory can be discussed under three key lines. These are capital budgeting, capital structure and working capital management. Capital budgeting and capital structure are typically connected to funding and management of long-term investments. Financial decisions about working capital on the other hand are more of short-term investments funding and management, handling both current assets and current liabilities at the same time (Brealey and Myers, 1996; Damodaran, 2002; Aksoy, 2005). Thus, referring to short-term financial management as working capital management on most occasions is justifiable (Ross et al., 2003).

In working capital management efficiency is very critical for every organization. However it is especially vital for a firm who manufacture products i.e. (Production firms) whose assets are normally made up of current assets (Horne and Wachowitz, 1998). This is because it affects liquidity and profitability of any firm directly (Raheman and Nasr, 2007). Kargar and

Bluementhal (1994) advanced the idea that firms" whose operations are based on erroneous procedures in the management of their working capital have higher probability of finding themselves in insolvency, irrespective of the fact that they constantly record positive profit.

Therefore, it must be avoided to withdraw from optimal working capital level by bringing the objective of profit maximization to the center stage, or on the contrary, concentrate only on liquidity and accordingly neglect profitability. It is true that an excessive level of working capital can easily lead to a below average assets return; shortages and difficulties in maintaining daily operations would result from insufficient amount.

2.6.2 Working Capital as Major Source of Capital

For small sized firms, medium sized firms and firms‟ with high growth rate the main external capital source is working capital. These three groups of firms have comparatively limited access to capital markets and have a tendency to overcome this difficulty by short-term borrowing. An overall assessment of such firms‟ working capital position is not an internal firm-specific matter, but also a significant sign of risk for creditors (Moyer et al., 1992).

A higher amount of working capital helps a firm to fulfill its short-term obligations and commitments easier. This leads to an increase in borrowing ability and a decrease in default risk and resulting decrease in capital cost and increase in firm value. Thus, it is likely to state that efficiency and effectiveness in working capital management affects has an effect on short-term financial performance, profitability and also on long-term financial performance which is firm value maximization.

2.7 Managing Working Capital Finances

To manage working capital effectively every investment made has to be paid at the time of acquisition as cash payment or sometime in future as credit. Being able to pay in cash or deferring payment to a later period is considered to be a source of financing. Credit availability as a funding source could be an option for the management to consider because of factors like high liquidity risk and culture.

2.7.1 Component of Working Capital Finances

Internal generation of external acquisition is the main source of funds for financing investment in working capital. Whiles borrowing or securing of the firm‟s current assets are means by which some firms take care of their financing difficulties, sale of current assets is the alternative for others. Trade credits, accruals, short-term bank loans, commercial papers, collateral papers, and factoring accounts receivable are the major sources of short-term finances when a firm uses its current assets to borrow (Horne, 1980).

2.7.1.1 Trade Credit Financing

Most firms are forced by the pressure of high competitive to offer trade credits to customers; otherwise, their preferred option would have been cash sales instead. Trade credit in contrast to credit offered financial institutions, is based on the reputation and trustworthiness of the customer rather than on formal collateral (Fafchamps, 1997). The accounts payable which is a common short-term financing source among businesses that have credit purchase policy is created by trade credits. This involves allowing the buyers of the products to defer payment for a short period of time after they have taken delivery of the products and make payment at a later agreed period, with or without earlier payment discount.

Three types of credit are available according to Horne (1980), namely; trade acceptance, promissory note payable and the open account. Trade acceptance is a bank‟s written supporting letter to a creditor on a specific transaction that guarantees the credibility of a debtor. It is common in global transactions. Promissory note payable is a written statement in the form of a note or letter by a debtor. It is used in transactions where the risk of loss is high because the amount involved is very high for open account and the creditworthiness of the debtor in the transaction has not yet been fully established. An open account on the other hand is an agreement between two parties in a transaction where the goods together with the invoice covering the goods are shipped by the seller to the buyer of the goods. The invoice states the kind, the quantity, the price and the terms of sale of the goods. This is more common of the three credits. The most common type of account is the open accounts arrangement, where the seller ships goods to the buyer along with an invoice that specifies the goods shipped, the price, the total amount due and the terms of sale.

2.7.1.2 Short Term Loan Financing

According to Block and Hirt (1992), the trade-off between profitability and liquidity risk will be contradictory affected by the source of finance. In dealing with the financing of working capital, short and long-term debt profitability is looked at in the context of interest cost. Profitability is negatively related to the interest cost. Therefore, rising cost of interest is expected to cause profitability to fall and vice-versa. Long term borrowing is more profitable for the lender than short term borrowing because of the higher risk involved in long term borrowing and its associated high interest charges. For the borrower, there is higher risk with short term borrowing in relation to long term borrowing. The reason is that, with short term borrowing there is a high risk of unpredictability in the interest rates and the borrower faces a lot of challenges in assessing such facility when compared with long term borrowing (Moyer et al, 1998). The long term loan is of low risk but more expensive, whereas short-term loan is of high risk but less expensive to the borrower. Management must therefore get a best balance among the two. According to Petersen and Rajan (1997), trade credit forms the single largest single short-term financing source for the United States, a nation with highly developed financial market. Fisman (2001) observed that, when it comes to the financing of a firm‟s operations in developing countries trade credit is of significant importance because formal lenders are not enough.

2.7.2 Short Term Debt Mix

Whiles short-term borrowed funds are to be utilized in the financing of temporary current assets, long term debt or equity capital are used in the financing of the permanent current assets of the firm. This is this financing logic. Nonetheless, management‟s approach when it comes to risk and profitability is the main determinant of the firm‟s actual investment and financing mix match-up (Horne and Martin, 1996). Interest cost and liquidity risk informs management on the usage of either maturity matching, conservative, or aggressive strategies when it comes to working capital investments financing.

2.7.2.1 Maturity Matching (Hedging) Strategy

This strategy matches to the maturity of the assets of the business with the maturity of its liabilities. In this case the current assets maturity are arranged to precisely correspond to the maturity period of the current liabilities. Hence, the maturity of assets balances with their corresponding financing instrument. Current liabilities are used in the financing of temporary current assets but equity capital and long term debt are used in financing of both fixed assets and permanent current assets. Maturity matching strategy recommends for the firm to only use borrowed short-term funds for the part of long-term debt that is current and non during periods of low sales. In times of seasonal asset needs, the firm makes use of short-term borrowing and when low sales occur once more, the firm repays the debt with cash from the current assets decrease (Horne and Wachowicz, 1998).

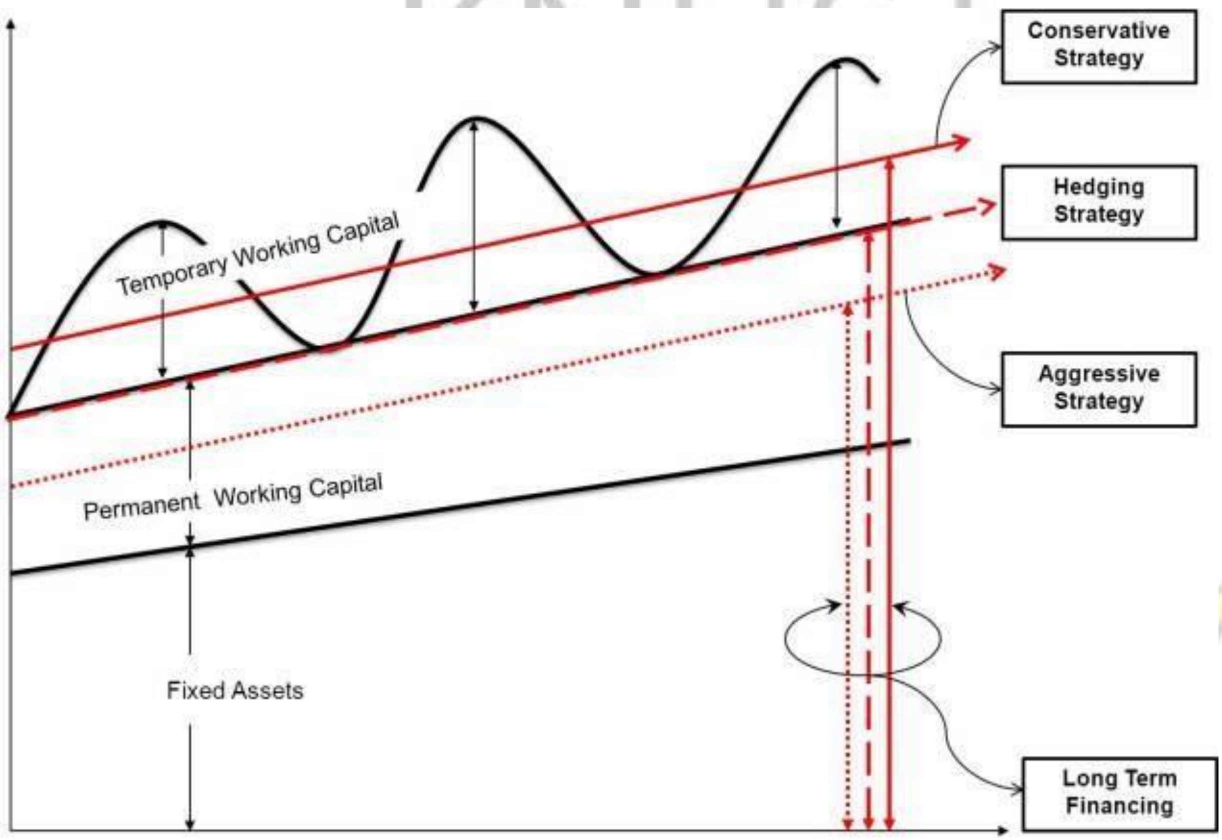
2.7.2.2 Conservative Strategy

Conservative Strategy however, it is a financing the working capital strategy where the company is exposed to low liquidity risk and have low profitability. A company that makes use of the conservative strategy finances their non-current assets, permanent current assets and part of temporary working capital with funds from long term financing sources. The strategy has a relatively lower liquidity risk but higher interest expenditure (Watson and Head, 2010).

2.7.2.3 Aggressive Strategy

The third working capital strategy is the aggressive strategy. As the name suggests this is the most aggressive strategy among the three strategies. This strategy is extremely focused on the profitability of the company. The strategy finance temporary working capital completely and a portion of permanent working capital with the short term funds. Whiles non-current assets as well as a portion of permanent working capital are only funded with long term funds. This makes the strategy is a high risky and profitable one. The interest cost is saved at the cost of high risk (Watson and Head, 2010).

Figure 2.2: Illustration of the three funding strategies



Source: www.efinancemanagement.com

2.8 Conclusion

The ultimate motivation for business investment is the commensurate return. In the long term owners of firms expect the firm to generate return on their invested capital. The long term worth of the firm consist of the aggregate its short-term values. The generation of the short term value is handled by the firm"s management of working capital. WCM consist of taking control of the firm"s the short term purchases and sales operations together with financing and investment.

WCM therefore encompasses the firm"s management of its cash investment, payable and receivable accounts, inventories and sources of finance in the short term. Although the future success and survival of the business is dependent on WCM, most of the SMEs have been found to poor and inefficient in this regard. A high percentage of the total firms that ends up in insolvency are attributable to the abysmal performance of SMEs in managing their working capital especially in receivables management. This can be dealt with by putting well-qualified and highly experienced managers in charge or by consulting one.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter provides description and justification for the methodological approach that has been used in the collection of data for this study. Qualitative and quantitative approaches to research have been adopted by this study. This mix of qualitative and quantitative approaches has many challenges. However this approach is deemed more effective as each complement the other and makes the study results more precise and reliable. The chapter covers research design, population sampling, instrument used, data collections procedures and analysis, and the profile of Pokupharma Limited.

3.1 Research Design.

A case study research strategy has been adopted by the researcher. The recognition of case study as a feasible research tool is partly because it is a convenient and meaningful technique that gives a time - framed perspective of the research under review (Merriam, 1998). The „face-value credibility‟ of evidence or illustrations provided by case studies also makes it appealing to readers (Bassey, 1999). This research design or strategy provides holistic, in-depth investigation as well as rich understanding of the studies and the process being performed (Feagin et al, 1991; Morris and Wood, 1991).

Case study was chosen as the preferred method because it enables the study to achieve its main aim of assessing the working capital management of Pokupharam Limited effectively and making a more representative conclusion. The decision to use case study was arrived at after a careful study and in depth method review was made of related literature as to how to research in to an area where both qualitative and quantitative analysis was to be made to get a right representation of the results.

3.2 Population.

The study focused on the management and the employees of the company in Fumesua, Kumasi where the company is located and operates from. The total population was made up of the management and staff of the company.

3.3 Sampling Methods

Non-probability sampling methods of both purposive and convenience sampling were employed in the study. Purposive sampling provides the opportunity to select cases that will best enable the through the judgement of the researcher to meet the objectives of the study. Neuman (2005) pointed out that the employing of purposive sampling in case study research that often has a very small samples is very suitable. This method was used in the case of top management members.

Convenience sampling however, involves haphazard selection of the cases that can be easily obtained for the researcher"s sample (Saunders et al., 1997). The convenience sampling was used for the low level management members and staff of Pokupharma Limited.

3.4 Sample Frame

The sampling frame was determined after an in-depth analysis of Pokupharma Limited was done. This involved ascertaining the various financial activities carried out in the various departments of the company as well as their functional managers and appropriate sample frame was then determined and used for the study. The sample frame consist of two directors, six senior managers, two administrative staff and twenty sales personnel.

3.4.1 Sample size

Out of the sample frame, a sample size was selected based on the individual‟s understanding of the subject matter, and their availability. Two directors, four senior managers and six staff of the company constituted the sample size. It was based on the study‟s established objectives that the sample was accordingly selected.

3.5 Primary Data.

The data analysed and used in the study included primary research data. Primary research data involves the collection of original information specifically in present of particular objectives. The researcher visited Pokupharma Limited to collect the primary data. Interview was the data collection tool used by the researcher to gathered information from the management and staff of the company. By using primary data the study was able to gather first-hand reliable information significant to the study.

The following key management staffs were interviewed for the analysis: Director of Finance and Administration, Director of Operations, General Manager, Accounts Manager, Accountant and Store Manager.

3.6 Secondary data

Secondary research data includes the collection of data from existing sources and the researcher conducted a detailed research of secondary data on the following lines.

- Analysis of annual audited accounts from FY2008 – FY2013
- Analysis of the monthly and quarterly management reports of the company

3.7 Tools of Data collection

Informal interviews were the data collection tool employed for this study. The interviews that were used were designed to offer qualitative information on the existing practices of working capital management in the company and to allow suitable recommendation.

3.7.1 Interviews

The researcher relied on the secondary data for the study, however interviews was used to seek first hand inform and also confirm information from other respondent. The interview was also used to ascertain information that was not covered by the secondary data. This was geared towards having more qualitative data that could better the results of the study.

Interview usage in the study is considered suitable as it offered the researcher the opportunity to closely interact with the interviewees. The intended purpose was to allow respondent to express their views whiles at the same time offering the opportunity to ask any relevant questions that came up in the course of the interaction.

The structured questions were used to solicit information from respondents in the form of interviewer-administered questionnaires. The questions were written on papers and the respondents ask to respond to them.

Further, the study used semi-structured questions to clarify the responses that were unclear. It was during the process of the interview that these questions were formed and ask for clarification where necessary.

3.8 Data analysis

The data collected was analyzed both descriptively and quantitatively. Charts such as trend graph and tables were utilized to aid in the descriptive analysis. Further, the study employed ratio analysis to evaluate the working capital management of Pokupharma Limited between different time periods. Financial ratios were applied in the estimation of all ratios in the study. Statistical packages like Statistical Package for Service Solution (SPSS) and Microsoft Excel were the main tools that were employed in analyzing the data. All charts and graph were drawn using Microsoft Excel.

Analyses of the open-ended questions were done by listing all the important responses provided by the respondents. The responses were then considered based on their significance to the study.

This gave the general ideas about the problem in question.

3.9 Profile of Pokupharma Limited

3.9.1 Brief History

Pokupharma Limited, a limited liability company, has been registered under the company‟s code 1963(Acts 179). It commenced business on the 5th of March 1995 after the Chief executive officer (Dr. Kwame Opoku) complied with the provisions of companies‟ code and the Pharmacy act 1994(Act 489) section 30 and 31. It started operations in two (2) small offices with ten (10) distribution vans for distribution and less than twenty (20) staff at Asafo near the Ahmadiyya Mosque.

3.9.2 Restructuring and Expansion

In the year 2005, a sister company called Marina Chemist Company was registered with the assistance of Ayrton Drug Manufacturing Company to solely handle the distribution of Ayrton products. Dr. Kwame Opoku, thirsting for expansion and willing to serve his growing customers better, relocated to a more spacious ultramodern office complex at Fumesua, directly opposite the Crop Research Institute (CSIR) in 2006. Staff increased to seventy five (75) and distribution vans increase to 30. This is an epitome of dedication, hard work and a growth of the company‟s capital.

In 2011, the Pokupharma Limited restructured to absorb Marina Chemist Company and at the same time started manufacturing pharmaceutical products at its premises after it acquired a manufacturing license. The company now has about two hundred (200) staff, forty five (45) distribution vans and produces thirty five (35) products on its premises. It also recorded over three thousand five hundred (3,500) customer base and twenty five (25) suppliers at the end of 2014.

3.9.3 Operational Areas

To ensure customer satisfaction, the company‟s distribution network has been re-designed to cover not only the entire country but to concentrate more on the rural areas. Pokupharma Limited‟s distribution vans ensure that their products reach all the pharmacy, chemical sellers, wholesalers and hospitals within the country. It is also working strenuously to enter the international market. The company‟s products are laced under nine (9) segment. They are:

1. **Pain Killers:** Molfen tablets, Pocumol tablets and syrup Cafalgin tablets and syrup, , Pofinac Caplets, Pocumol Extra Tablets, Brufen 400mg Tablets, Diclofenac 50mg and 100mg tablets, Pocupain tablets and suspension, Famacap capsules, and Pobucap capsules.
2. **Blood Builder:** Rodex syrup, Minarol syrup, Jarifan 2 syrup, capsules and drops, and Nabil Iron syrup.
3. **Multivitamins:** Raidavit syrup, Emgivit tablets, Nutramin drops, and Nahak Multivitamin syrup.
4. **Appetizers:** Odymin syrup and capsules, Leena Syrup and capsules, and Cyfen syrup and tablets.
5. **Antacids:** Re-zot blister and Suspension
6. **Anti-Malaria:** Artetine tablets, Lufan tablets, Quinine syrup and tablets, and Malarid
7. **Dewormer:** Minazol tablets and suspension.

8. **Anti-cold:** Pofakoff Syrups and Lozenges, Malin syrups and Lozenges, Tinpac tablet, and Pocucold Tablet.

9. **Menstrual Pains:** Menstak tablets Femimex tablets

10. **Cosmetics and Antiseptic range:** Good Care cocoa butter, Good Care moisturizing lotion (almond), Good Care moisturizing lotion (musk), Good Care moisturizing lotion (aloe vera), Good Care skin lightening lotion, Good care antiseptic (1000ml, 500ml, 250ml and 100ml) ,Good Care sanitary pads Good care condoms and Jazz perfume.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND DISCUSSIONS

4.0 Introduction

This chapter presents detailed analysis, results and discussions on Pokupharma Limited working capital management policy before and after the restructure and expansion. The study has discussed in detail the data and information gathered from the various interviews and observations. With the aid of financial ratios, the secondary data collected has been presented in table forms, analyzed and interpreted. Financial ratios for assessing the financial and operational performance of firms were applied because they are easy to understand and interpret. Statistical tools were engaged in the analysis as well.

4.1 Sources of Finance for Pokupharma Limited

The sources of the company's finances are both external and internal. The company uses its retained profit and sometimes short-term loans from their bankers. This is as a result of the company"s continuously insufficient working capital. The company has been using conservative funding policy as working capital financing strategies. Pokupharma Limited employs long-term funds to finance not only non-current assets and permanent current assets, but a portion of temporary working capital as well. Because Pokupharma Limited uses the conservative funding policy, there is less reliance on short-term funding. Hence, the liquidity risk of such a policy is lower, but the higher cost of long-term finance means that the company"s profitability dwindles correspondingly. Discussed below are the external and internal sources of finance for the company:

4.1.1 External Sources

The main external sources as revealed by the study are from the company's Bankers and Suppliers Trade Credit.

(i) Banking Facilities

Examinations by the study revealed that the company has been using the following banking facilities:

Short-term loan facility has been used at least once for a period of one year as a working capital supplement for the manufacturing department of the company since the restructuring and expansion. Although the use of this facility was rare before the restructuring took place. Because of the company"s good financial standing with its bankers, the company does not face problems when securing loans from their bankers to meet both for short-term and medium term obligations or to even start new projects.

(ii) Suppliers Trade Credits

Credit is considered to be a flexible, security-free and interest-free source of working capital financing. During the period prior to restructuring Pokupharma Limited used an average of 26 days to make payments to creditors. But, the company used an average of 140 days to pay its suppliers as against average of 105 days allowed by the suppliers during the post-restructuring times. The reason cited for this enormous increase in average payment period is due to the longer period for payment offer by the foreign suppliers of raw materials, since it takes relatively shorter period to transform finished goods into cash than raw materials. It should however be noted that trade credit is not free of cost because the cash discount is lost when the trade credit period is taken and can be very expensive. Moreover, this resulted in some suppliers incorporating the cost of the credit into their pricing policy while others could withdraw the credit facility to the company. This confirms the argument put forward by Berger and Udell (1999) concerning the cost and risk associated with over reliance on trade credit in working capital financing.

4.1.2 Internal Sources

This is basically from internally generated funds (IGF) and effective management of company‟s inventory and account receivables. As at the end of 31st December, 2013, the balance on the company‟s income surplus account was GHS 738,736 which was internally generated funds used as part of the company‟s fixed and current capital. In comparison, the balance as at 31st December, 2012 and 31st December, 2011 were GHS 464,202 and GHS 384,445 respectively. The amount consistently rose during the three post-restructuring period. However, the amount was relatively higher during the pre-restructuring era, with the exception of the FY2010"s GHS 78,544. GHS 977,362.82 and GHS 763,622.96 were the amount recorded for FY2009 and FY2008 respectively. The high amount of income surplus in the pre-restructuring period was due to the lower cost of expenses at the time; the employee level was for instance less than half of the post-restructuring period. Other expenditures like insurance and maintenance cost of plants and equipment, cost of fuel for powering plant and equipment, exchange losses etc. barely existed. These income surpluses are not withdrawn from the company but plough back into the business as reinvestments.

4.2 Exploring the Cost Effectiveness of Inventory Management of Pokupharma Limited

Pokupharma Limited faces challenges with the proper management it"s of inventory especially during the post-restructuring period (FY2011-2013). The challenge has been the company"s inability to effectively balance its production and customers" requirement of inventory levels and at the same time minimized the costs of its inventory. However none of these objectives can be achieved without effective planning and analysis of the inventory involve and the company lacks these important competencies.

Inventories of Pokupharma Limited during the post-restructuring period has been mainly raw materials acquired from suppliers for production and sale afterwards. Although the company holds finished goods the value during the post-restructuring period was not as high as that of raw materials with the exception of FY2011. Whereas GHS 252,679.00, GHS 1,312,495.00 and GHS 1,534, 420.00 are the values of inventory for FY2011, FY2012 and FY2013 respectively, the values of finished goods were GHS 535,103.00, GHS 596,497.00 and GHS 668,513.00.

The flow of cash is fundamental to running of all companies, irrespective of the size. Cash Conversion Cycle forms the central operation system of Pokuphama Limited and it is the difference between the time inventories of the company were purchased and the time the company collects cash for the sale of the products. To continuously finance the purchases of inventory for the business operations, the cash is required.

The basic inventory cost that the company incurs includes purchasing cost of the inventory, ordering cost, and carrying cost. The purchase cost can easily be identified because the price is stated outright on the pro-forma invoice and subsequently the commercial invoice, together with the sale conditions and payment terms. The suppliers of Pokupharma Limited do not offer any discount neither prompt-pay discount nor quantity discounts for the inventory they supply the company. However, the inventory purchasing cost is opened to negotiation when the pro-forma is sent to the company. The terms of payment for the inventory after the restructuring are usually in the form of Letters of Credit (LCs), ranging from 60 days to 180 days. But on rare occasions the payment are made in advance. The situation was quite different in the pre-restructuring period since the inventories was mostly acquired locally and pay for within a month.

There is also the ordering cost. The ordering cost of the company includes all cost that is associated with the order placement and the corresponding payment processing. The ordering costs for the company in the post-restructuring era are in the form of freight, import duty charges, clearing agent fees and carriage inwards. With the exception of carriage charges from the above mentioned ordering costs, the rest were mainly non-existent during the prerestructuring era. The company incurs these order cost ordering before the inventory reaches the shelves and pallets of the company. There is also the cost of holding the stock which can also be referred to as carrying cost which involved cost associated with the having the inventory in the company‟s warehouse. This includes cost like interest on capital invested in the stock, storage charges (rent, lighting, air-conditioning etc.), stores staffing, equipments maintenance, insurance etc.

The alternative to the company not having inadequate levels of inventory and as such low cost of carrying cost is to be exposed to stock-out costs. These costs have to do with the cost of the company running out of stock. Investigations and checks by the researcher revealed that this used to be a rampant situation during the early post-restructuring era of 2011 and 2012. This is was due to the company being new to the manufacturing sector at the time and was therefore experiencing series of unexpected shocks in demand and lead time. Pokupharma Limited faces shrinkage cost as well. This is where the inventories are rendered unfit (product obsolescence) for either production or sales. Theft cases involving inventory also forms part of the shrinkage cost.

Pokupharma Limited has been using the perpetual inventory system during the pre-restructuring and the post-restructuring periods. The system provides details of the inventory quantities and values whenever they are needed. Each purchase made by the company is recorded as well as any sales that occur. This is done through the use of computerized accounting and financial software, QuickBooks Enterprise Solutions: Wholesale and Manufacturing Edition and it are backed by tally cards recording. However, a less user friendly computer software of Microbits was used during the pre-manufacturing era in the management of inventory along with tally cards. An example of how the tally card recordings are done is demonstrated in Figure 4.1 below:

Figure 4.1: Example of Perpetual Inventory record for Ibuprofen

POKUPHARMA LIMITED
TALLY CARD

ITEM:	***IBUPROFEN B.P.***	STOCK NO.:	***PL/RM/061***
QTY. UNIT:	***KG***	MINIMUM STOCK:	

Date:	Receipts		Issues		Balance on hand	
	Qty.	GHS	Qty.	GHS	Qty.	GHS
03/10/2013	300	500.00			300	1,500.00
07/10/2013			60	300	240	1,200.00
08/10/2013			90	450	150	750.00
19/11/2013			60	300	90	450.00
27/11/2013	300	525.00			390	2,025.00

As soon as the company received an order it entered into the system to be added to the quantity on hand to be reflected as the new level of inventory. The products‟ invoices are then submitted to the accounting department to be collated and for payment to be carried out on the due date. Inventory auditing is also conducted by personnel from the accounting department.

With the exception of the physical facilities, inventories constitute one of the highest uses of Pokupharma Limited‟s cash. The revenue from the sale of inventory is used in the various aspects of the company‟s operations. High levels of inventory have been affecting the cash flow of the company and consequently its efficient operation. The study in assessing the effectiveness of inventory control techniques in a company‟s operations employed the financial ratio called inventory turnover ratio. Table 4.1 below is the inventory ratios for both pre-restructuring and post-restructuring era.

Table 4.1 Inventory Turnover Ratios

INVENTORY TURNOVER RATIO						
	FY2013	**FY2012**	**FY2011**	**FY2010**	**FY2009**	**FY2008**
	(times)	(times)	(times)	(times)	(times)	(times)
Inventory Turnover Ratio	4.6	4.7	11.6	15.7	12.6	14.2

Source: Pokupharma Limited, Audited Financial Statement (Various Financial Years)

Generally, an average of about 30 days inventory on hand for operation is considered to be ideal. This is approximately 12 turns per year. The items that have higher "turns" are "fast movers" in the pharmaceutical industry. These fast movers improve the profitability of the company.

Pokupharma Limited‟s turnover ratios for the periods prior to the start of its manufacturing operations indicate overall effective inventory control techniques with a little over 14 turns on the average. The post-restructuring inventory control techniques on the other hand have been deteriorating. With the exception of FY2011 that was very close to the 12 turns per year optimal standard the rest have been poor performers. The reasons given for the most poor inventory turn was overestimation of inventory needs of the company. Breakages, damage, and obsolescence were also cited by the stores‟ manager. The relatively lower ratios for FY2012 and FY2013, is an indication of inefficient use of inventory. The implication is that most of the inventories were just idly sitting on the shelves of the company. This affected the company‟s profitability since most of the cash were tied up and was not available to be use in other areas to generate more revenue.

The inventory management system of the company has not been as effective as expected. There is no technique of inventory management such as Economic Order Quantity (EOQ) and Just-inTime in place. Meanwhile, maximum and minimum levels of stocks are not routinely monitored. Typical of many trading and manufacturing companies in Ghana, no combination of economic analysis and statistical formulae are used in the setting of inventory levels. The only inventory control system in place is first-in-first-out (FIFO).

However, the weighted average cost (AVCO) inventory valuation method is employed by the company. The AVCO has been described as the middle ground between FIFO and LIFO inventory valuation method. In the calculation of the AVCO per unit, the cost of goods sold (COGS) available for sale is divided by the sum of units for the period. The reason cited for the use of the method of inventory valuation is the fact that it levels out the market fluctuations effects in inventory prices.

The inventory, on average constituted almost 50% of the current assets investment. The size of inventory as part of the current asset has generally been increasing. Although this increase in percentage terms dropped in the beginning period of the expansion from the 87% in FY2010, the amount nevertheless increased. The amount of inventory in FY2013 alone was of GHS 2,202,933 representing 61% of the current assets of the company, with FY2012 and FY2011 recording 51% and 35% respectively. The company has been carrying too much inventory incurring more carrying cost as well as opportunity cost of foregone interest. This is an ineffective way of managing inventory.

4.2.1 Cash Trapped in Inventories

Loneux (2003) of London's REL Consultancy Group Limited argued that one of the main causes of organizations‟ insolvency is the cash trapped in stocks. The study revealed that holding of large quantities of stocks, worth millions of Ghana cedis at the warehouses of the company has been the norm in the post-restructuring era (FY2011-FY2013). The study found large stocks of inventory that were moving slowly as well as others that were not required for production any time soon.

The main problem has been poor inventory management and lack of forecasting of the inventory needs of the company resulting in cash trap in inventory. Most of these issues were not present when the operations of the company were just "buying-and-selling" (FY2008-FY2010).

4.3 Trends in Financial and Operational Performance of Pokupharma Limited

Information on the company"s financial and operational performance was gathered basically from the financial statements, quarterly internal management reports and responses to the interviews granted. The data revealed the following about the company"s financial performance during the period under study (FY2008-FY2013).

Table 4.2 Summary of Financial Performance (FY2008 - FY2013) - Ratio Analysis

	RATIO	FY2013	FY2012	FY2011	AVG.	FY2010	FY2009	FY2008	AVG.
EFFICIENCY RATIOS									
1	Stock Turnover (days)	79.4	77.48	31.44	**62.77**	23.19	29.08	25.7	**25.99**
2	Average Collection Period (days)	31.71	44.45	35.82	**37.33**	1.66	11.67	13.83	**9.05**
3	Average Payment Period (days)	123.96	181.77	115.14	**140.29**	47.03	12.17	17.65	**25.62**
4	Working Capital Cycle (days)	-12.85	-59.84	-47.89	**-40.19**	-22.18	28.58	21.88	**9.43**
LIQUIDITY RATIOS									
5	Current Ratio (times)	0.92	0.78	0.76	**0.82**	0.57	2.03	1.23	**1.28**
6	Quick Ratio (times)	0.36	0.38	0.49	**0.41**	0.07	0.87	0.55	**0.50**
PROFITABILITY RATIOS									
7	Gross Profit Margin (%)	18.04	18.67	16.98	**17.90**	7.63	9.02	9.09	**8.58**
8	Net Profit Margin (%)	2.22	0.75	3.22	**2.06**	0.02	1.71	-0.2	**0.51**
9	Return on Capital Employed (%)	18.62	10.85	62.62	**30.70**	70.03	21.93	13.07	**35.01**

Source: Pokupharma Limited, Audited Financial Statement (Various Financial Years)

4.3.1 Efficiency

Efficiency ratios measures how well the resources of the company have been looked after. It shows how the company‟s assets and liabilities are utilized internally. The efficiency ratios used in the study to assess Pokupharma Limited is discussed below:

4.3.1.1 Average Inventory Turnover Period

The average inventory turnover period is used to estimate the number of days inventory are available for sale. On average the company used 63 days to convert its raw stocks into cash after the restructuring compared the average of 26 days before the restructuring. The reason given by management for the almost tripled days in average inventory turnover period was the fact the company has to manufacture the products. This requires keeping of a substantial level of inventories especially in the form of raw materials and work-in-progress to avoid stock-out cost which did not exist during the buy-and-sell period.

Nonetheless, the recent average inventory turnover of approximately two months seems a bit excessive for a pharmaceutical manufacturer. This is because sickness is not sometimes that is entirely under human control, therefore irrespective of the day or month people will need some kind of medication for sale to take place. Although some pharmaceutical products sell better during certain period than others, the company can also analyze the trend and schedule their purchases as such. This will help to reduce the inventory conversion period to the minimum appropriate level to avoid unnecessary costs in carrying materials which are not of immediate use.

4.3.1.2 Average Debtor Collection Period

The company takes 37 days on the average to collect its debt from the customers after the restructuring as compare to the 9 days it was using during the period before the restructuring. Nonetheless, the credit period on the company‟s credit policy was and remains 21 days. It can be said that management of Pokupharma Limited has been slow and inefficient in their debt collection after the restructuring. Although the period it takes to collect its debt is still less than the period the suppliers allow, per Pokupharma Limited‟s credit policy the management is not doing as expected of them in their debt collection efforts. The current state of affairs indicates that the customers hold on the company funds for 16 extra days than the company wants them to.

The management of the company blames the recent poor performance on the intense competition in the manufacturing industry these days which has given the customer more power than before. The general economic hardship in the country was also cited as reason for the slow in demand and economic activities as a result.

4.3.1.3 Creditor Payment Period

On average Pokupharma Limited paid its total suppliers of goods and services every 140 days for the period from 2011 to 2013. This compared to the average of 26 days before the start of manufacturing. The average of 140 days in recent times still far exceeds the debtors‟ average period of 37 for the same period, which should be good for the company since this means they are using less of the company‟s funds and more of creditors for their operations.

The average debtors period has been quite long since the start of manufacturing because most of the company‟s raw materials suppliers are outside the country with payment terms often been Letters of Credit (LCs) of at least 60 days. But the payment period can be as long as 180 days.

The local suppliers on the other hand offer an average credit period of 30 days which was also the days allowed by the suppliers before the manufacturing started.

4.3.1.4 Working Capital Cycle

The period from FY2011 to 2013 showed the working capital conversion period as -48, -60, and -13 days respectively with an average of -40 days. The period from FY2008 to 2010 on the other hand showed the working capital conversion period as 22, 29, and -22 days respectively with an average of 9 days. The cash conversion cycle or working capital cycle in *X* days means that it takes *X* days to turn an investment into cash and profit. The more extended the cash conversion cycles the higher the investment of the company in the working capital. The negative working capital ratios is not an usual results as companies like McDonalds and Amazon sometimes records negative working capital cycles. This is an indication that managers ought to invest the supplier cash in short term investment to generate extra income before the creditor payment period is due. Reduction in the length of the cash conversion cycle can result in a decreased in cash investment in the current assets (Cheatham 1989). This should be possible by decreasing the inventories days, by extending the creditor deferral period or by reducing debtor collection period. The post-restructuring period recorded negative working capital cycle throughout, implying the company has been superb in negotiating with suppliers. This has led to the company"s ability to negotiate for a longer period with its creditors" whiles negotiating for lesser day with customer. The negative days means the company is technically using their creditors" funds for their operations.

4.3.2 Liquidity

Liquidity ratio is a measurement of the ability of the company in meeting its short-term obligations out of its total cash as and when they are due. The company liquidity ratio has not been impressive since FY2010. This showed that the company is not financially strong to meets its obligations as they fall due. Poor management of working capital has the resulting effect of funds being unnecessarily tied up in idle assets, hence reducing liquidity. The company‟s performance in term of liquidity is as follows:

4.3.2.1 Current Ratio

The current ratio is an indication of the company‟s financial strength. This ratio represents how many times Pokupharma Limited‟s current assets are more than its current liabilities, which is a signal of the solvency of the business. These ratios for the post-restructuring period were 0.76, 0.78, and 0.92 for FY2011 to FY2013 respectively with an average of 0.82. A current ratio of 2:1 is deemed safe for a trading company like Pokupharma Limited and less likely to have liquidity problems. This tells management that current assets cover current liabilities 0.82 times. In other words, the company can use the total current assets of the company to pay for only 82% of the total current liabilities. This means the company is not liquid enough, since the total current asset also include are a less liquid asset like inventories which takes time to convert into cash. This liquidity situation was quite better during most part of the pre-restructuring era with an average of 1.28 times, which is better than the post-restructuring ratio. The company was able to meet the general rule of thumb of two-is-to-one in FY2009 with a current ratio of 2.03 times. The business since then does not have sufficient current assets to meet the scheduled payments of current liabilities with a margin of safety. The reasons for this is the continuous rising of the company‟s current liabilities mostly for the purchase of inventories. The solution lies in decreasing the level of the company‟s inventory level to the point where only those with immediate use will be kept.

This will consequently reduce the borrowing requirement of the company to result in decreasing current liabilities.

4.3.2.2 Quick Ratio

The more liquid measure of financial strength that focuses on comparing just cash and receivables to current liabilities without considering stocks showed an average of 0.41times for the period after the restructuring and 0.50 times for the period before the restructuring. This ratio therefore simply compares the most liquid assets to the current liabilities of the company. The quick ratio is a test of the company"s capability in meeting its obligations even in the face of unfavorable business situations.

The ratio recorded has given the indication that the company liquidity has actually worsen since the start of manufacturing by Pokupharma Limited. The only explanation management gave was the fact they company have invested a lot in non-current assets since the restructuring started and this has affected the state of liquidity of the company. In general, a quick ratio of 1:1 is viewed as acceptable, on condition that there no anticipation of slow movement in receivables collection.

4.3.3 Profitability

Profitability ratio is a measurement of the company"s ability to generate profit out of its business activities. Pokupharma Limited operating performance has generally not been steady but fluctuating in terms of profitability.

4.3.3.1 Gross Profit Margin

The gross profit margin is a measure of the effectiveness of the company at trading. The gross profit margin of the company has seen improvement since FY2011. The gross profit margin before the restructuring was quite low compared to more recent trends. The average margin for the period prior to the restructuring was 8.58% compared to the post-restructuring ratio of 17.90%, which is actually more than double. This means that on the average after paying for purchases and other direct costs, Pokupharma Limited was left with 8.58 pesewas to pay for other general and administrative expenses for every GHS 1 of sales from 2008 to 2010. The figure improved from 2011 to 2013 with an average of 17.90 pesewas.

This improvement has been attributed to management efforts to reduce cost of goods sold, and this has also affected the net profit margin of the company.

4.3.3.2 Net Profit Margin

The net profit margin of Pokupharma Limited has not been that strong over the years, however, the performance after the restructuring has been better than it used to be before the restructuring. Whereas the average for the period before the restructuring was 0.51%, the percentage improved to an average of 2.06%. This implies that after paying for all operating expenses, for every GHS 1 of sales revenue generated an average of 2.06 pesewas remained as profit for the period after the restructuring. This was an improvement on the 0.51 pesewas of profit on every GHS 1 of sales revenue. In this case management is working hard to make the company profitable. This has resulted from management effort in cutting down expenses level as much as possible in relation to sales.

4.3.3.3 Return on Capital Employed (ROCE)

The return on capital employed was quite high in FY2010 and FY2011 with 70.03% and 62.62% respectively. Although the ratio peaked in FY2010, there has not been any consistent pattern or trend in terms of ROCE for the period before and after the restructuring of the company. The return on capital employed reflects how efficient the company has been during the FY in using the capital invested in the company to generate profits. This implies that on the average the company generated 30.70% profits on investment in capital for the company after the restructuring and 35.01% profit on investment before the restructuring took place. That is for every GHS 1 investment in the company during the period after the restructuring, an amount of 30.70 pesewas was generated as return on that investment, compared to the 35.01 pesewas before the restructuring. A good ROCE generates profit that is higher than the rate on borrowed funds.

4.3.4 Trend in Net Working Capital

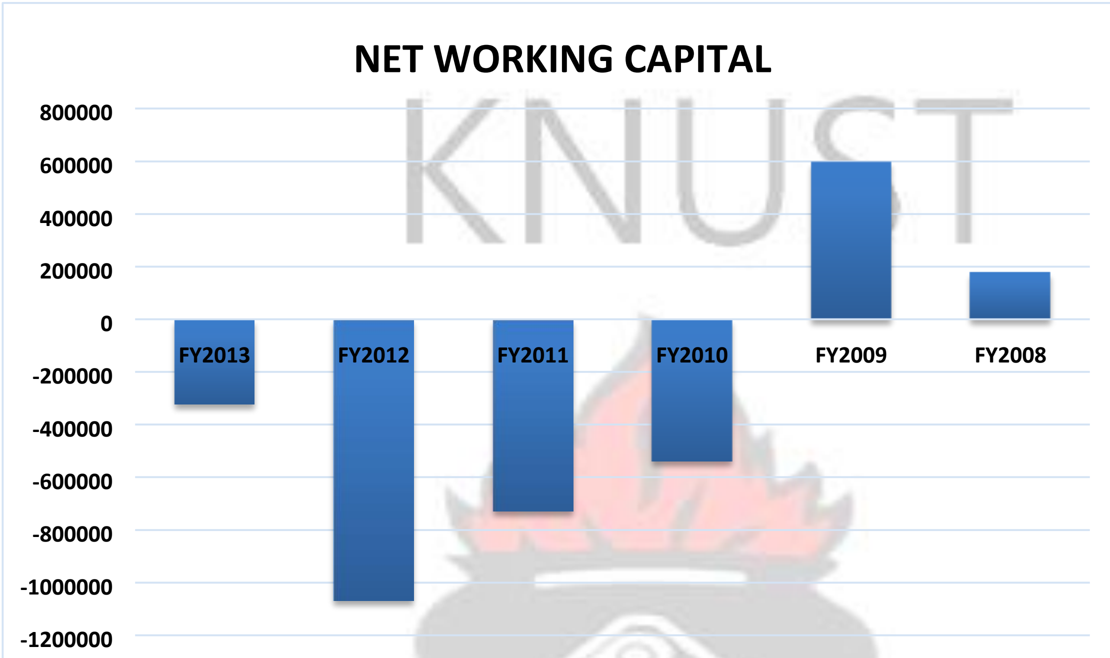
The main objective of working capital management is to make sure that there are no interruptions in the company‟s operations and there are enough cash available to meet both maturing short-term debt obligations and impending operational expenses. Table 4.3 below shows a summary of the Pokupharma Limited‟s net working capital.

Table 4.3 Trend in Net Working Capital

NET WORKING CAPITAL						
	FY2013	**FY2012**	**FY2011**	**FY2010**	**FY2009**	**FY2008**
	GHS	GHS	GHS	GHS	GHS	GHS
Current Assets (CA)	3,596,196	3,754,189	2,256,168	725,059	1,175,498	934,804
Current Liabilities (CL)	3,917,500	4,821,171	2,984,062	1,263,939	577,934	757,364
Net Working Capital (CA-CL)	(321,304)	(1,066,982)	(727,894)	(538,880)	597,565	177,440

Source: Pokupharma Limited, Audited Financial Statement (Various Financial Years)

Figure 4.2: Trends in Net Working Capital



Source: Pokupharma Limited, Audited Financial Statement (Various Financial Years) (GHS)

The company‟s working capital position for the period under consideration suggest that the company is having problems in the fulfilment of its obligations in the short-term since FY2010. The company‟s net working capital performance for FY2013 was the best of the three postrestructuring periods and it is a good improvement of the situation in FY2012. But in comparison to the pre-restructuring times, it is really bad. Pokupharma Limited was chalking positive net working capital in FY2008 and FY2009, before the restructuring took place.

In view of the recent persistent trend of current liabilities exceeding current assets, company needs to work on the management of its payables particularly its trade payables to ensure that the situation gets better in subsequent years. The company‟s operational activities depend too much on the funds of its trade creditors and needs to be checked. This position of the company is a clear reflection of the calculated liquidity ratios.

4.3.5 Trends in Account Receivables

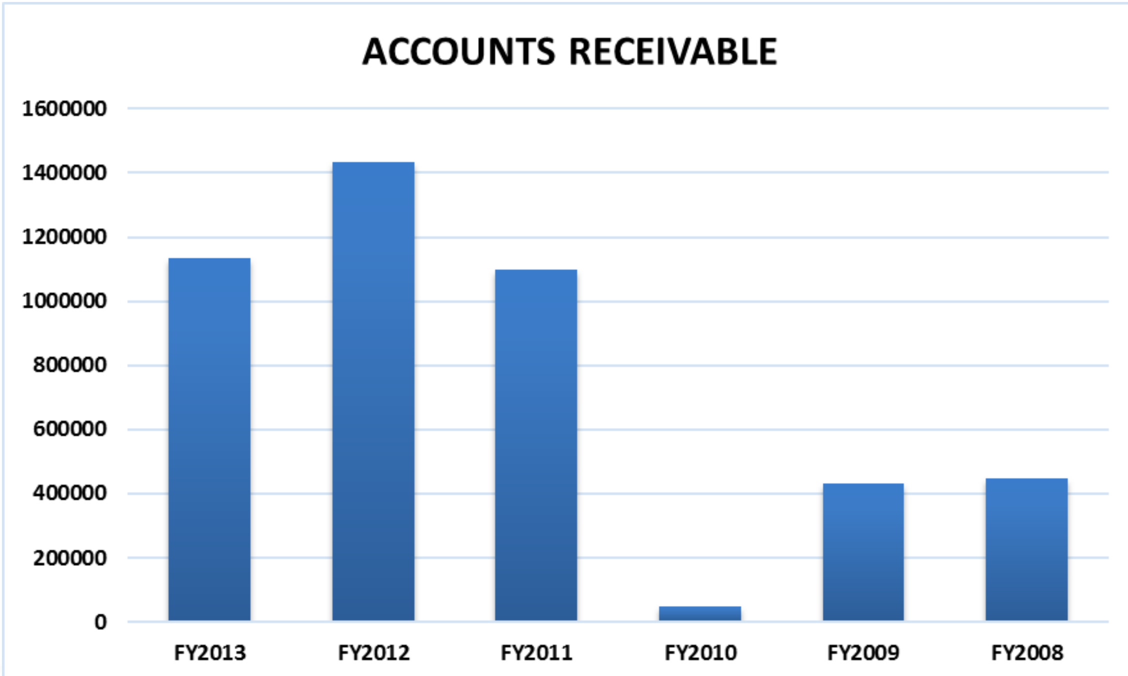
The company takes an average of 37 days to collect its outstanding debt from the debtors during the post-restructuring times. Specific days for the respective years under the period are 36, 44, and 32 days for FY2011 to FY2013 respectively. However, the situation was quite different in the pre-restructuring era which saw an average collection period of 9 days with 14, 12 and 2 days for FY2008, FY2009 and FY2010 respectively. The post-restructuring average is over two weeks more than the company‟s credit period of 21 days allowed under the credit policy. The Accounts Receivables are presented in table 4 below as follows:

Table 4.4 Trends in Accounts Receivable

ACCOUNTS RECEIVABLE						
	FY2013	**FY2012**	**FY2011**	**FY2010**	**FY2009**	**FY2008**
	GHS	GHS	GHS	GHS	GHS	GHS
Trade Receivables	1,073,377	1,346,649	1,081,229	48,770	297,792	306,603
Other Receivables	12,237	3,537	-	-	-	-
Prepayment	13,788	19,263	17,773	-	12,555	17,432
Staff Loans & Advances	100	-	800	-	-	-
Directors' Current Account	33,917	63,439	-	-	120,743	125,115
Total	1,133,419	1,432,888	1,099,802	48,770	431,090	449,149

Source: Pokupharma Limited, Audited Financial Statement (Various Financial Years)

Figure 4.3: Trends in Accounts Receivables



Source: Pokupharma Limited, Audited Financial Statement (Various Financial Years) (GHS)

Pokupharma Limited has significant amount of its current assets in account receivables. On the average account receivables makes up approximately 40% of current assets investment. The size of this account as part of the current asset has been falling over the post-restructuring period (FY2011-FY2013). The major component of this account has been trade receivables forming about almost 96% of the total accounts. This calls for a prudent management of the receivables since failure in this instance could cause the company liquidity problems.

4.3.6 Trends in Bank and Cash Position

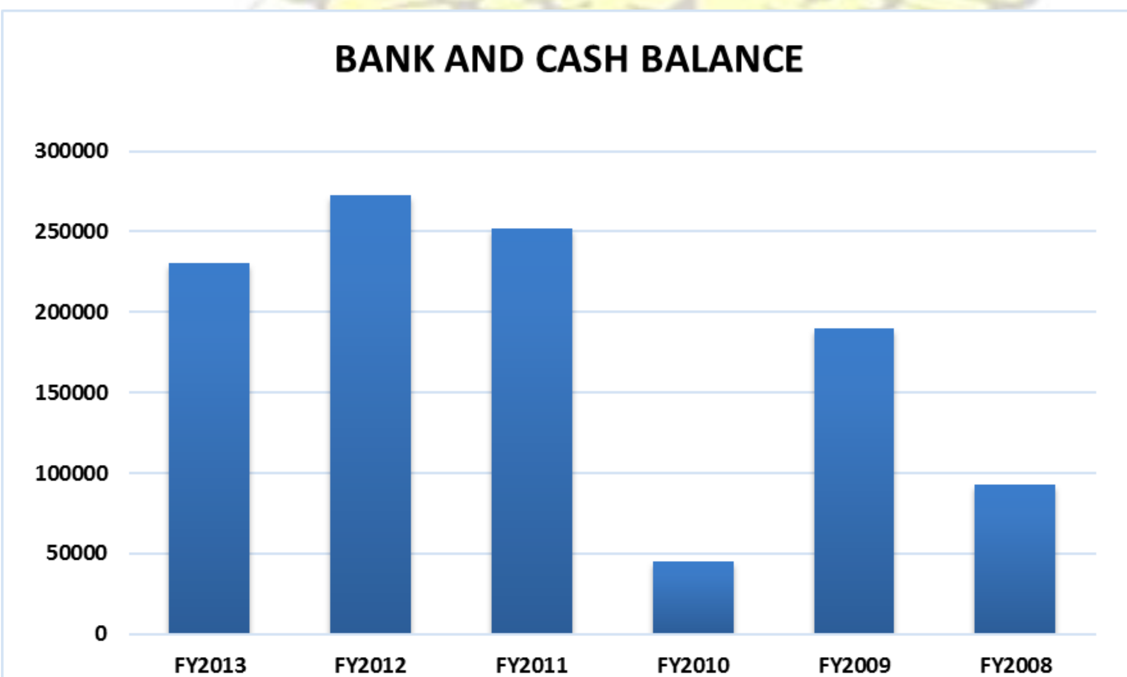
The company"s cash management practices were very poor. Key techniques such as cash forecasting, cash flow statements administration and internal controls which are considered to be effective means of managing a firm‟s liquidity, minimizing the cost of funds and maximizing interest earnings, (Moores, 1999) were not efficiently applied before and after the restructuring.

Table 4.5: Trends in Bank and Cash Positions

BANK AND CASH BALANCE						
	FY2013	**FY2012**	**FY2011**	**FY2010**	**FY2009**	**FY2008**
	GHS	GHS	GHS	GHS	GHS	GHS
Cash at Bank	220,670	271,499	176,977	43,306	183,893	84,187.14
Cash in Hand	9,587	833	74,607	1,785	5,800.00	8,456.00
Total Balance	230,257	272,332	251,584	45,091.00	189,693	92,643.14

Source: Pokupharma Limited, Audited Financial Statement (Various Financial Years)

Figure 4.4: Trends in Bank and Cash Position



Source: Pokupharma Limited, Audited Financial Statement (Various Financial Years) (GHS)

The company has consistently shown poor cash management practices. The company after FY2010 on the average keeps the suppliers funds for approximately 35 days deposited at the bank and made to lie idle to the benefit of the bank without investment. Excess funds should be put to profitable use to enhance the earnings of the company especially short-term interest earning investments. The end of year cash and bank balance for the years under review were too much to be left idle any investment.

4.3.8 Trends in Account Payables

On average the company paid its total suppliers of goods and services every 140 days in the postrestructuring era which far exceeded the credit period of 21 days granted to its debtors. 115, 182, and 124 days were used to pay its total creditors for FY2011 to FY2013 respectively. The days were far less in the pre-restructuring era with 18, 12 and 47 days for FY2008, FY2009 and FY2010 respectively. The average payment period at the time was 26 days.

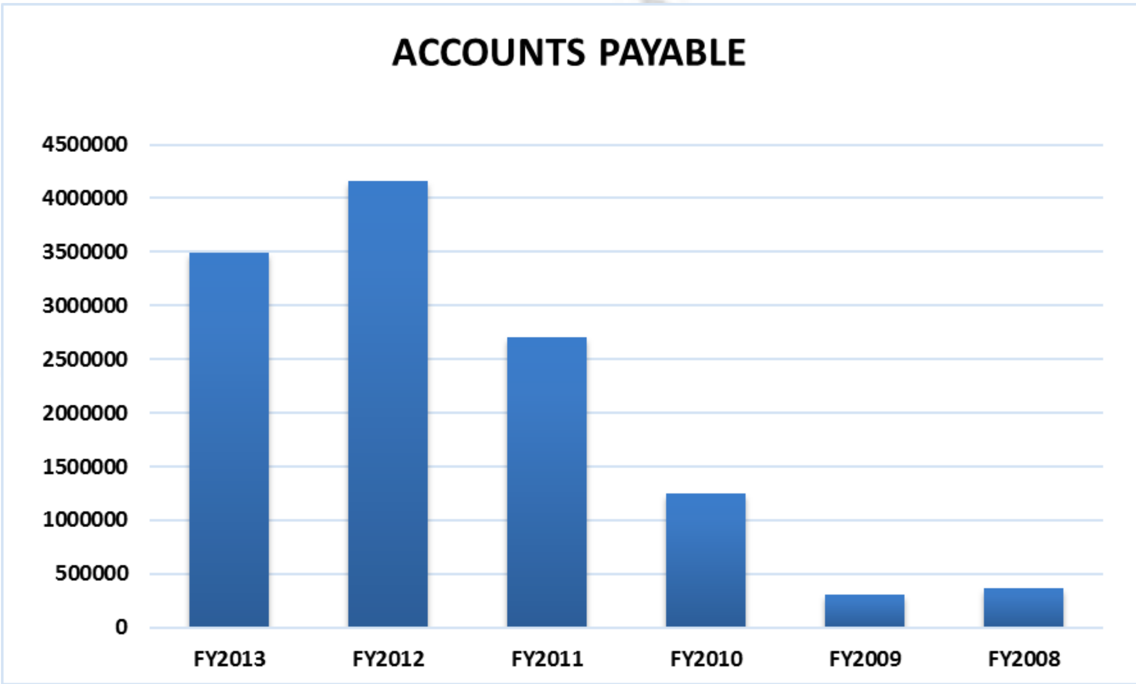
Table 4.6: Trends in Account Payables

ACCOUNTS PAYABLE						
	FY2013	**FY2012**	**FY2011**	**FY2010**	**FY2009**	**FY2008**
	GHS	GHS	GHS	GHS	GHS	GHS
Trade Payables	3,300,900	3,914,918	2,597,519	1,238,723	299,893	365,619
Other Payables	184,397	241,804	78,292	-	-	-
Accrued Liabilities	5,175	4,600	4,000	6,000	7,687	4,594

Director' Current Account	-	-	20,517	-	-	-
Total	3,490,472	4,161,322	2,700,328	1,244,723	307,580	370,214

Source: Pokupharma Limited, Audited Financial Statement (Various Financial Years)

Figure 4.5: Trends in Accounts Payables



Source: Pokupharma Limited, Audited Financial Statement (Various Financial Years) (GHS)

The company has substantial amount of its current liabilities in account payables. The average account payable is approximately 88% of the total current liabilities for the post-restructuring period. The major component of this account has been trade payables forming about almost 95% of the total account payables. The company has been working with this substantial trade credits as part of its working capital.

4.4 Factors that Promotes or Inhibits Working Capital Management in Pokupharma Limited.

The study found these factors to be positive in the promotion of working capital management in the company during both the period before and after the restructuring took place:

The study revealed that the company utilizes computers in the company‟s operations. This increase the efficiency of the company, since the use of computer and appropriate software tremendously increase the company‟s ability to manage its working capital. The company was found to employ accounting and financial software like QuickBooks Enterprise Solutions: Manufacturing and Wholesalers Edition and Microbit in managing its working capital during the period before and after the restructuring. This has helped the company in tracking its inventory levels, sales analysis, account receivables and account payables in a more effective manner. This revelation is not in different from study of McChlery et al, (2004) observed the enhancement of working capital management efficiency by firms through the application of computerized accounting system. Whiles Raymond and Magnenat-Thalmann (1982) revealed the increase in computerized accounting in the management of account receivables, account payables, sales analysis and inventory.

These factors on the other hand were found to be inhibiting the promotion of working capital management in Pokupharma Limited during the period prior to the restructuring and after the restructuring as well as:

4.4.1 Cash Management

After examining the company‟s working capital management practice, the study revealed these cash management practices of Pokupharma Limited. Firstly, preparation of cash budgets is not always done. The infrequent preparing and reviewing cash budgets are commonly based on monthly periods in the not many times it has been done. It was revealed during the study that Pokupharma Limited often employs cash budgets as mechanism for the planning and controlling of the company‟s cash flows. Alternatively, the determination of cash balance that is held by the company is done by the Chief Executive Officer of the company through his experience. This place more importance on experience than theory in practicing cash management.

Although large portions of surplus cash were deposited at the bank, the company is not aware of the various ways of using temporal surplus cash profitably. The company was found to left these cash with banks without taking advantage of any of the short term interest earning facilities. In this case the company has challenge in dealing with cash surplus instead of cash shortage. It is essential to keep some amount of cash for unforeseeable expenditure in the business environment; too much cash is sitting idle is not good. This is because it will affect profitability. The trade –off between profitability and liquidity needs to be cautiously examined. This is a signal of cash management practices inefficiency which is in support of Dodge et al (1994), who pointed out that the management of cash flow happens to be an internal problem of small and medium businesses which required identification.

4.4.2 Receivable Management

With respect to receivable management, Pokupharma Limited on more occasions sells its products on credit although it allows for cash payment as well. The company however does not sell to new customer on credit. Selling on credit is a common trend among pharmaceutical companies of Ghana. However, the company does not employ any credit officer in managing its credit like most Ghana companies (Agyei-Mensah, 2012).

Again, the study found out that Pokupharma Limited reviews its bad debts and receivables levels quarterly and it is not shocking that there is high reporting over age debt. With regards to employment of credit appraisal, to assess the level of product that can be supplier to a customer only few sales personnel perform it. The company‟s focus on accounts receivables management is not as high as expected. This finding confirms Atrill‟s (2006) observation that most SMEs do not have the required resources in effectively managing their receivables. He further advanced the idea that operating without credit control department in place is uncommon practice for SME. The impression gathered indicates lack of both knowledge and the experience on the part of most of the sales personnel in making good decision with reference to term of sales. Hence the company has deficiency in proper debt collection procedures. The risk of late payment and defaulting debtors in such a situation will be high.

With the current economic environment of high inflation, exchange and interest rates where returns are already low bad debts is a detrimental problem for the company. Pokupharma Limited that sells most its products to majority of its customers on credit faces a high risk of large amount of bad debt.

4.4.3 Inventory Management

Finally, for inventory management practices, Pokupharma Limited has little knowledge regarding inventory management theories. Notwithstanding there is frequent preparation of inventory budget and review. The challenge is in the application of inventory management theories in the budget of inventory. Pokupharma Limited bases the level of inventory requirement on the experience and perception of the general manager with no reference to historical data and trends. The manager in charge did not have knowledge on economic order quantity (EOQ). The company‟s reliance on the experience of the manager overrides the application of inventory management theories. While the manual method of inventory control was the preferred and practiced inventory control method employed by the company. This result is not different from the study of Chittenden et al (1998) that found more than 30 percent of respondents to their SMEs survey relying on manual method of inventory control.

In the post-restructuring years, due to the fact company‟s the company‟s main suppliers of raw materials are found outside the shores of Ghana, and raw materials on the average takes 45 days to be received. This means that when the company purchase raw materials and the materials do not physically meet the required laboratory test then replacement becomes a problem. This is because it will take at least another 45 days for the materials to be delivered to the company.
This will likely cause disruption in the production and sale of the company‟s products. With such an intense competition in the pharmaceutical industry in Ghana, the company is likely to lose some customers before the problem is solved.

4.5 Conclusions from the Analysis.

It can be seen from the above analysis that, general working capital management of Pokupharma Limited is not satisfactory, though the period before the restructuring was relatively better compared to the post-restructuring times. There is therefore the urgent need to refocus the management of working capital of the company to include having formal working capital strategy, proper liquidity management activities and introducing financial information system to develop financial discipline in working capital management.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter summarizes the study‟s main findings arising from the analysis, provides conclusions and finally outlines the recommendations for considerations by the management of Pokupharma Limited to enable the company address its working capital management problems.

5.1 Summary of Major Findings

Inference from the previous chapter‟s analysis is that Pokupharma Limited has not been good at managing their working capital particularly after the introduction of the manufacturing department in its operations. The study findings include; the company‟s utilization of manual methods of inventory with apparent no knowledge of Economic Order Quantity (EOQ) inventory management technique. Over-reliance on the experience of management as against the utilization of tried and tested inventory and cash balances theories was revealed. Pokupharma Limited has been deficient in the managing of receivables as well. There are also no proper procedures for debt collection as well as no credit officers.

The trend of turnover for the period under review did showed steady and satisfactory performance. The amount grew from the FY2011 figure of GHS 11,017,942 to GHS 11,058,304 in FY2012. It further rose by more than 1 million Ghana cedis to GHS 12,355,877. But these figures were not reflected in the net operating profit which for FY2012 and FY2013 recorded net operating loss of

GHS 55,933 and GHS 256,073. It was only in FY2011 that the company recorded a net operating profit of GHS 301,057 during the period under consideration.

Gross Profit showed a continuous growth throughout the period which was satisfactory. Though the Gross Profit increased during the period, it cannot be said to be outstanding performance. The percentages rose from GHS 1,871,225 in FY2011 to GHS 2,064,805 in FY2012 and continued to rise further to GHS 2,228,551. The gross profit margins for the period were 16.98%, 18.67%, and 18.04% for FY2011, FY2012, and FY2013 respectively.

The company‟s liquidity is significantly affected by the poor management of working capital which ties up funds needlessly in idle assets whereas profitability is also affected due to the company‟s inability to invest in productive assets like plant and machinery.

The company experienced trend of continuous fluctuation in working capital with negative net working capital throughout the period. The company‟s current assets kept on fluctuating during the three-year period under review from GHS 2,256,168 in FY2011 to GHS 3,754,189 in FY2012 and went down to GHS 3,596,196. The current liabilities was also unsteady for the period as was the case of current assets, rising from GHS 2,984,062 in FY2011 to GHS 4,821,171 in FY2012 and then falling GHS 3,917,500. The liquidity position of was therefore very poor and unsatisfactory, resulting from the following deficiencies in working capital management: Lack of adequate cash management practices, lack of proper inventory management resulting in to working capital tied up in stocks. The company's failure to set benchmarks for periodic working capital ratios analysis, preferably on monthly bases, has resulted in inefficient use of the working capital.

Pokupharma Limited had a planned approach in managing its accounts payable and stocks but seriously had problem in managing its accounts receivables and cash balances. The credit policy and collection of receivables due to credit within the 21 days were not adhered to appropriately. Key techniques such as forecasting, cash flow statements administration and internal controls which are considered to be effective means of managing a firm‟s liquidity, minimizing the cost of funds and maximizing interest earnings were not efficiently applied.

5.2 Conclusion

After a careful assessment of the findings, the study concludes that the general working capital management of Pokupharma Limited is not effective and satisfactory although the company deserve applause when it comes to sales figures and the seriousness attached to the use of computerized accounting. Hence, the company should urgently refocus the management of its working capital. Considerable work is required to address the company's working capital problems.

Precise information, and clear understanding of the important component in the various working capital element is a requirement for the achievement of improvement in the company‟s performance. Whereas reducing capital tied in unproductive and surplus to requirements assets will enhance the company‟s cash flow and reduce its costs. Accordingly, continuous growth and development of Pokupharma Limited can be achieved by applying a multi-dimensional models of current assets mix.

5.3 Recommendations

In consideration of the results from the previous chapter and the concluding remarks, the following measures are recommended to help in addressing the liquidity problems and ensuring efficiency in working capital management of Pokupharma Limited.

There is an urgent need for a formal working capital strategy of the company whereby proper and effective standards for the management of working capital are followed to lessen the market risk and for maintaining optimum quantity of inventory. Pokupharam Limited has to plan, monitor and make effective use of its working capital.

Liquidity management activities should be more organized through regular measurement of working capital, preferably monthly, for quick identification of the trend and any looming liquidity problems that require to be addressed immediately. All idle funds which have no immediate use should be put into productive investments like treasury bills. Pokupharma Limited also should employ superior inventory management methods like Economic Order Quantity and Just-in-Time purchasing system. Whiles maximum and minimum level of stocks are to be routinely monitored to curtail over stocking of certain product lines. Financial forecasting, planning and control tools at the same time are to be intensively utilized to enhance cash management effectiveness.

Pokupharma Limited should have a credit control policy that clearly spells out the terms of trade such as the credit period and discount allowed. The credit appraisal of customers should be carried out to access the creditworthiness of each customer especially new ones. This will provide information in the establishment of limits in terms of amount and time. Periodic review of existing customers, especially those who wish to raise their credit limit should be carried out.

The company should develop a better relationship with the customers as well, as this enhances prompt payment. The customers that are late in their payment should also be reminded through phone calls promptly.

In the management of inventory, inventory levels for seasonal products like Famacold tablets and syrup for influenza that fluctuate should be monitored and balanced with expected demand. Periodical physical review of the inventory needs to be conducted to ensure reduction in inventory carrying costs of slow-moving or obsolete items to improve cash flow. Due to the fact that the carrying costs and can intensely impact profitability, the company should be keeping average inventory level at the appropriate minimum. But it should be enough the meet customer demands. In addition financial information should be utilized in such a way that adequate profitability can be achieved from the levels of inventory while keeping an eye on inventory related financial ratios. Finally, it is the recommendation of the researcher that further detail research on the various components of working capital should be conducted so that SMEs, particularly in Ghana, can continuously improve their working capital management.

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APPENDIX A

INTERVIEW GUIDE

WORKING CAPITAL MANAGEMENT AT POKUPHARMA LIMITED

NOTE: The study is for academic purpose only and any information will he held confidential.

The restructuring of the company has brought about changes in the components of working capital. This study is meant to find out how working capital is managed at Pokupharma Limited before and after the restructuring.

1. What is the procedure for authorizing purchases in the organization?
2. Looking at your financial report, your current liabilities have consistently been exceeding the current assets, how do you explain this?
3. How does the firm finance its working capital?
4. How often does the company rely on overdraft to support its operations?
5. What means does the firm use in paying its employees?
6. Does the firm sometimes have to pay employees in arrears?
7. Does the firm sometimes have disputes with its suppliers and customers on payments?
8. Which short-term marketable securities do you hold?
9. How is the company able to pass any increases to customers through price increases?
10. If a supplier of goods or services lets you down can you charge back the cost of the delay?

APPENDIX B

POKUPHARMA LIMITED

INCOME STATEMENT

YEAR ENDED 31 DECEMBER;

	2013	2012	2011	2010	2009	2008
	GHS	GHS	GHS	GHS	GHS	GHS
SALES	12,355,877	11,058,304	11,017,942	10,756,512	9,318,105	8,093,290
OPERATING COST						
Direct Cost	10,127,326	8,993,499	9,146,717	9,936,357	8,477,751	7,357,590
General and Admin. Expenses	2,484,625	2,120,738	1,570,169	818,502	680,736	662,883
	12,611,951	11,114,237	10,716,886	10,754,859	9,158,487	8,020,473
Operating Profit/ (Loss)	(256,074)	(55,933)	301,056	1,653	159,617	72,817
Other Income	530,732	138,399	53,387	-	-	-
Profit Before Taxation	274,658	82,466	354,443	1,653	159,617	72,817
Provision for Taxation	(124)	(2,708)	(48,542)	(24,515)	(17,673)	(5,566)
Profit for the Year	274,534	79,758	305,901	(22,862)	141,944	67,251

APPENDIX C

POKUPHARMA LIMITED

STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER;

	2013	2012	2011	2010	2009	2008
	GHS	GHS	GHS	GHS	GHS	GHS
NON CURRENT ASSETS						
Property, Plant and Equipment	4,395,101	3,618,722	1,627,148	749,139	506,541	717,298
CURRENT ASSETS						
Inventory	2,202,933	1,908,992	787,782	631,198	675,458	518,126
Accounts Receivables	1,133,419	1,432,888	1,099,802	48,770	310,347	324,035
Short Term Investments	-	125,308	117,000	-	-	-
Bank and Cash Balance	230,257	272,332	251,584	45,091	189,693	92,643
	3,566,609	3,739,520	2,256,168	725,059	1,175,498	934,804
CURRENT LIABILITIES						
Bank Overdraft	261,543	58,539	41,315	11,327	261,021	240,765
Accounts Payable	3,490,472	4,161,322	2,700,327	1,244,723	307,580	370,214
Taxation	(29,587)	(14,669)	38,031	7,889	9,332	4,566
Loans	165,485	601,310	204,388	-	-	141,820
	3,887,913	4,806,502	2,984,061	1,263,939	577,934	757,364
NET CURRENT ASSETS/(LIABILITIES)	(321,304)	(1,066,982)	(727,893)	(538,880)	597,565	177,440
	4,073,797	2,551,740	899,255	210,259	1,104,105	894,738
Long Term Liabilities	(1,717,627)	(470,105)	(253,849)	(125,715)	-	-

NET ASSETS	2,356,170	2,081,635	645,406	84,544	1,104,105	894,738
REPRESENTED BY						
Stated Capital	6,000	6,000	6,000	6,000	6,000	6,000
Deposit for Shares	199,000	199,000	199,000	-	-	-
Capital Surplus	1,412,434	1,412,434	55,960	-	120,743	125,115
Income Surplus	738,736	464,202	384,445	78,544	977,363	763,623
	2,356,170	2,081,636	645,405	84,544	1,104,105	894,738