

INTRODUCTION

This introductory chapter will be divided into seven sections each of several paragraphs. The content of this chapter will provide a general overview of the research subject, as well as explaining the structural aspect of the research.

Section One: General Overview:-

Concept of working capital management:

The term working capital refers to the amount of capital which is readily available to an organization to conduct its normal course of business. That is the difference between resources in cash or convertible into cash within short period (Current Assets) and organizational commitments for which cash will soon be required (Current Liabilities).¹

Current Assets are resources which are in cash or will soon be converted into cash in the ordinary course of business.

Current Liabilities are commitments which will soon require cash settlement in the ordinary course of business".

Working capital represents investment in short-term assets such as short-term securities, accounts receivables, cash and inventories. Net working capital is defined as current assets minus current liabilities. Working capital management refers to all aspects of the administration of both current assets and current liabilities. Current assets holding should be expanded to the point where the marginal return on increases in such assets are just equal to the cost of capital required to finance these

¹ Davidson.K, modern accounting,,Kaplan publisher,United Kindom,1997, Page 65.

increases, while current liabilities should be used in place of long-term debt whenever their use lowers the average cost of capital.

Thus: the formula of the new working capital will be as follows:-

$$\boxed{\text{NET WORKING CAPITAL} = \text{CURRENT ASSETS} - \text{CURRENT LIABILITIES}}$$

These components of working capital are reported in the balance sheet under the following headings:

Current Assets:

- Inventory
- Trade and other Receivables
- Liquid Assets (cash and bank deposits)

Current Liabilities

- Trade and other Payables
- Other Short Term Liabilities
- Bank Overdraft

Therefore, there are two general working capital concepts; net working capital and gross working capital. Net working capital is the difference between current assets and current liabilities. This concept is useful to those interested in determining the amount and nature of assets that will be used to pay current liabilities. On the other hand gross working capital refers to the amount of funds invested in current assets, employed in the business process. This is a going concern concept since it deals with assets that financial managers are using to carryout operations and bring about targeted productivity.

Classification of working capital management: -

Working capital may be classified into two ways; the first classification is directly related to the gross concept of working capital; that is working capital may be classified as being capital invested in various components of the current assets such as cash, inventory and receivables. This classification is helpful since it categorizes the various areas of financial responsibility. These items require careful planning and control if the firm to maximize its return on investment. This classification is more important to financial management, but it is not completely adequate since it ignores the time factor. In the light of the importance of the time factor and its impact on the formulation of procurement policies, the second classification according to time is considered necessary. Using time as a basis, working capital may be classified as either permanent or temporary.¹

Permanent working capital is that amount of funds required to produce the goods and services necessary to satisfy demand at its lowest level. Such capital process may be characterised by the following: -

- a) Unlike fixed assets, which retain their form over a long period of time, permanent working capital is constantly changing from one asset to another.
- b) The fund of value representing permanent working capital never leaves the business process. Therefore, it is retained until the business ceases to exit.
- c) As long as the firm experiences growth, the size of the permanent working capital account will increase.

Temporary working capital like permanent working capital changes its form from cash to inventory and receivables and back to cash, but it

¹ Hadley.G, analysis of inventory system, 3rd edition, pioneer printing press, united kingdom, 1999, page 15.

differs in that it is not always gainfully employed. Businesses that are seasonal and/or cyclical in nature require more temporary working capital than the firms that are not of such nature. Therefore, managers should obtain the capital that is temporarily invested in current assets from sources that will allow its return when not in use. If this policy is followed, the turnover of investment will be more favourable and permit a more efficient use of capital.

Although seasonal and cyclical working capital may be obtained from the same sources, the contractual terms vary widely. For example, banks may be the principal supplier of both types, but the charges may be different. Moreover, contractual restrictions upon short-term loans will differ considerably from those placed upon long-term loan contracts.

Importance of working capital management for the firm's survival:

Working capital management includes a number of aspects that make it an important topic for study. Time devoted to working capital management is one of these aspects, as the largest portion of a financial manager's time is devoted to the day-by-day internal operations of the firm.

These day-to-day operations may be approximately sub-summed under the heading of "Working capital management". Since so much time is spent on working capital decisions, it is vital to be studied carefully. Another aspect of working capital management, is the investment in current assets; in manufacturing companies represent large investment and because this investment tends to be relatively volatile. Current assets are worthy of a financial manager's careful attention.

Working capital management is particularly important for small firms. Small firms may minimize their investments in fixed assets by renting

and leasing plant and equipments, but there is no way whereby they can avoid an investment in cash, receivables and inventories.

Therefore, current assets are significant for the financial managers of small firms. Further, because a small has relatively limited access to the long-term capital markets, it must necessarily rely heavily on trade credit and short-term bank loans, both of which affect net working capital by increasing current liabilities.

Relationship between sales growth and working capital:

The relationship between sales growth and the need to finance current assets is close and direct. That is if sales rises, the investment in account receivables may rise. In other words, if working capital is varied relative to sales, the amount of risk that a firm assumes is also varied and therefore the opportunity for gain and losses increase. This principle implies that a relation may exist between degree of risk that management assumes and the rate of return; that is the more risk that a firm assumes, the greater is the opportunity for gain or loss. An increased sale requires increased production, which in turn needs additional investment, perhaps additional cash balances.

All such needs must be financed, and since they arise so quickly it is important that the financial manager keep himself aware of the developments in the working capital segment of the firm. As continued sales increases will require additional long-term assets, which must also be adequately. However, fixed assets investments, while considerably important to the firm in strategic, long run sense, do not generally have the same urgency as do the current assets investment.

Section Two: Problem Identification:

The problem identified of the companies under study, which are relating to the sugar industry of the Sudan, has been characterised by the following:

- (i) Lack of sufficient capital which threatens survival and progress of the business of the companies and leave them work below their operating capacities.
- (ii) Insufficient liquidity, which is a sign of inefficient credit control and accumulation of stock items.
- (iii) Improper management accounting system, which leads to inefficient working capital management.

The problem can be summarized as; the companies under investigation are incurring hidden losses and suffering from lack of liquidity as consequences of inefficient working capital management.

Section Three:- Formulation of The Hypotheses

The hypothesis of the study are shortly and briefly stated as follows:

- (1) Proper management of working capital management involves planning and control of working capital components.
- (2) Adoption of efficient and effective working capital management techniques and polices, improves the firm's financial and operational performance of the designated firms.
- (3) Proper inventory control allows the firm to avoid incurring losses as a result of short falls or excess of inventory.
- (4) Good cash management Leads to maintaining adequate cash balance to meet current and long term obligations as they fall due.

(5)Efficient credit control polices safeguard the company against non-creditworthy customers.

Section Four: The Objectives and Importance of The Research

The purpose of the study

This study proposed to discuss how working capital is managed by financial managers of the selected firm of the study. Working capital management is a subject that deals with all aspects of capital management, such as how capital is acquired, how it is invested and how it would be allocated among long term assets and short term production operations.

However, this study concentrates on how capital would be invested in short-term firms operations (Working capital management).

The narrowing of scope does not imply that the other financial management aspects are not important. Conversely, all aspects of working capital management in a number of firms need to be studied in order to understand how it affects the firm's performance. However, the collection of the necessary information for such a study involves considerable amount of time thus, a part from brief references to these aspects where the latter are related to main subject. No more attention is given to them. The study specifically aims at appraising working capital management practices in those limited number of firms, which had been selected cross- sectionals to represent the sugar industry in Sudan. The study strives to identify the strengths and weaknesses of the practices, which are likely to affect the firm's liquidity and profitability.

Further, an attempt will be made to develop a system of working capital practices that may improve the firm's operating performance, liquidity and profitability in the light of the prevailing economic conditions.

Section Five: The Methodology and Source of The Information

This study follows a descriptive analytical approach, using financial analysis techniques and applying many of the scientific methods of study such as deduction, induction and the historical approach.

The method of data collection includes:

- (i) Primary data: This will be collected through series of interviews. The interview questions will be designed to elicit information about the method adopted in working capital management. The questions cover all aspects of working capital management.

Personal observation will also help in generating the primary data

- (ii) Secondary data will be obtained through precise and keen inspection of the reports, books of accounts and files, policy and procedure, manual and other records.

Section Six: The Organization of The Study:

The study is organized into an introductory and five chapters. The content of this the introductory part will explain mainly, the general overview of the research, the problem identification, formulation of hypotheses, the objectives and importance of the research, the methodology and source of information, the organization of the study and literature review.

Chapter one discusses a brief economic and industrial background relating to the progress and the prospects of sugar industrial sector and its impact on the national economy.

Chapter two is an overview of the concepts and theoretical aspects of working capital management.

Chapter three concentrates on analysis and evaluation of working capital management practices and policies of the selected firms.

Chapter four deals with field study analysis and observations.

Chapter five will deal with evaluations, conclusions and recommendations.

Section Seven: - Previous Studies

(1) V.L.GOLE Study (1997)¹

The hypotheses of this study are stipulated as follows:-

- Good managed working capital improves business profitability.
- Bad managed working capital leads to adverse business performance.

Methodology of the study:-

The researcher compared two companies' cases; one is well managed and the other is recklessly managed. The study confined on working capital component of the two companies.

Findings of the researcher:-

Well managed company	Recklessly managed company
Increased profit consistently	Incurred losses
No bad debts written off	Bad debt scored 26% of debtors
Slow moving stock items below .05	Slow moving stock items over 10%
In-house financed	Out source finance

¹ V.G.GOLL, Importance of good working capital management, Kaplan publisher, London, 1997, page 18.

Recommendations:-

The study recommended that in order to achieve high profit and good performance, an efficient working capital management is vital. That is credit policies, cash budget policies, stock control and procedures are to be created and precisely implemented.

Comparison of current study with previous one

There are some natural and timing differences between the current and previous study as the two studies were undertaken at different time as well as using different sources of information. However the conclusion of the current and the previous study are likely to be similar.

(2) MAXINE ABEL Study (2004)¹

The researcher examined the impact of working capital management on cash holdings of small and medium-sized manufacturing enterprises in Sweden. The aim of his work is to theoretically derive significant factors related to working capital management which have an influence on the cash level of small and medium enterprises and test these in a large sample of Swedish manufacturing small and medium enterprises.

The theoretical framework for this study consists of a treatise of motives for holding cash, working capital management and cash level.

From these theoretical findings, two hypotheses are deduced:

- H1: Cash holdings are negatively related to the presence of cash substitutes.
- H2: Cash holdings are positively related to working capital management efficiency.

¹MAXINE ABEL, The impact of working capital management on cash holdings, Mid Sweden University, 2004,page pp2-4.

Methodology of the study

The researcher based on the statistical analysis of companies' financial information. The result is either to confirm or reject the hypotheses which are based on theoretical foundations. The approach of measuring certain characteristics and their interrelation is labelled as "descriptive research"² by Hair as opposed to "exploratory research"³ which aims at discovering new knowledge in a field of study for which relatively little information exists. In this respect, a lot of studies have been conducted in the field of cash level and an alternative approach which is based on existing knowledge has been developed.

Findings of the researcher:

The empirical analysis reveals that cash holdings are influenced by working capital management. Cash levels are impacted by both the level of net working capital and its components as cash substitutes, i.e. inventory, accounts receivable and short-term liabilities, as well as the way in which working capital is managed, represented by the cash conversion cycle. This means that cash level is partly in the Small and Medium enterprises' sphere of influence and can be controlled by its financial decision-makers using working capital management related measures.

Recommendations:-

The researcher recommended that in order to have a short time lapse between payment for inventory and collection of sales, Cash conversion cycle to be decreased and repartition of working capital to be shifted from inventory or accounts receivable towards cash.

High Investment in cash is to be vested in firms with a High cash conversion cycle because the average holding of current assets will be low due to the fact that they are quickly turned over into cash.

Comparison of current study with previous one

There are some minor differences in the hypothesis, it also there are partial difference in the methodology of the research. Timing differences are inevitable implication as the two studies are carried in different periods; however, aims of the two studies are approved most similarities as well as findings and conclusions.

(3) WILLIAM KEITH Study (2006)¹

The researcher examined the effect of working capital management in financing price setting.

Financing pricing involves the price that a member of a multinational group charges a related party operating in a different jurisdiction for goods, services and intangibles. Within this context, the financing pricing discipline attempts to assign one or more of these related parties (herein referred to as the tested party) with arm's length returns determined from a group of third party comparable companies.

Methodology of the study

The researcher compared different multinational group of companies of which practicing proper financing price setting with those which ignore such practice and accept the financing price offered by the lender. Analyses of such data are mainly generated from the companies' financial statements. managed.

¹ William Keith, The effect of working capital management in financing price setting, , Washington,2006, pp 6-11.

The researcher outlined the basic Hypotheses as follows:

1. In a perfectly competitive environment each firm is assumed to be a financing price taker.

Implication: No one firm can affect market price through a change in supply.

2. Products that are sold within this model are perfect substitutes.

Implication: Any financing price discrepancy that exists between competitors will result in the firm charging a higher price losing market share.

Implication: No one firm will have a technological advantage over the other. As a consequence, the production process that each firm follows will be identical.

3. New firm entry is not restricted by barriers to entry.

Implication: If economic profits exist in the short run new firms will enter and eliminate all economic profits in the long run.

Findings of the study:-

Performing working capital adjustments are necessary to ensure that returns derived from a set of comparables can be reliably applied to a tested party operating in a non-arm's length setting. There is no theoretical argument that suggests that working capital adjustments should be rejected. The analysis has shown that operating in a perfectly competitive environment implies that working capital adjustments are a requirement. These findings are supported on theoretical grounds which are violated when different working capital intensities between firms exist. Given that firms are assumed to be financing price-takers, then the

only way that financing prices charged by all firms can be taken as given is if all of the factors that affect prices, including working capital intensities, are the same.

Recommendations:-

The researcher recommended that companies are to set financing price in accordance to the company's operational interpretation and market financing price simultaneously.

The researcher also recommended that, proper analysing for the need of external financing to the company is an inevitable practice for proper performance of the company.

Comparison of current study with previous one

This study is mainly approves the recommendations pertains to the financing part that related to the management of creditors of this study.

Most of the recommendations are similar and confirm each other