

ST. MARY'S UNIVERSITY
FACULTY OF BUSINESS
DEPARTMENT OF ACCOUNTING

**ASSESMENT OF WORKING CAPITAL
MANAGEMENT ON PROFITABILITY OF SMALL AND
MICRO SCALE ENTERPRISE IN ADDIS ABABA IN THE
CASE OF ARADA SUB-CITY WOREDA 1**

Prepared by: MINTESENOT GIRMA

SURAFELE HAILE

KALE TADESSE

Advisor: MEKONNEN A.

August, 22/2014

Addis Ababa, Ethiopia

**ASSESSMENT OF WORKING CAPITAL MANAGEMENT
ON PROFITABILITY OF SMALL AND MICRO SCALE
ENTERPRISE IN ADDIS ABABA IN THE CASE OF
ARADA SUB-CITY WOREDA 01**

**FACULTY OF BUSINESS
DEPARTMENT OF ACCOUNTING**

IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE DEGREE OF BACHELOR
OF ARTS IN ACCOUNTING

By: MINTESENOT GIRMA

SURAFELE HAILE

KALE TADESSE

Advisor: MEKONNEN A.

August, /2014

Addis Ababa, Ethiopia

ST. MARY'S UNIVERSITY

ASSESSMENT OF WORKING CAPITAL MANAGEMENT ON PROFITABILITY OF SMALL AND MICRO SCALE ENTERPRISE IN ADDIS ABABA IN THE CASE OF ARADA SUB-CITY WOREDA 1

BY

MINTESENOT GIRMA

SURAFELE HAILE

KALE TADESSE

BUSINESS FACULTY

DEPARTMENT OF ACCOUNTING

APPROVED BY THE COMMITTEE OF EXAMINARS

DEPARTMENT HEAD

SIGNATURE

ADVISOR

SIGNATURE

INTERNAL EXAMINER

SIGNATURE

EXTERNAL EXAMINER

SIGNATURE

ACKNOWLEDGEMENT

First of all we would like to thank our family next to God for everything they have done for us. Our next gratitude goes to our advisor Ato Mekonnen. A for his unreserved comments and advice from the beginning to the end of this research The contribution made by Ato Mulye and Reta and all the staffs of arada sub city woreda 01 for their support in distributing the questionnaires is to be highly remembered.

We are also grateful to our friends for their encouragement and moral support.

Table of Contents

ACKNOWLEDGEMENT	i
Table of Content.....	ii
LIST OF FIGURE	iv
LIST OF TABLE.....	v
ABRIVATION	vi
CHAPTER ONE	
1.1 INTRODUCTION.....	1
1.2 Background of the Study.....	2
1.3 Statement of the Problem	3
1.4 Research Question.....	4
1.5 Objective of the Study	4
1.5.1. General Objective.....	5
1.5.2. Specific Objectives.....	5
1.6. Significance of the Study.....	5
1.7. Scope of the Study	6
1.8 Research Design and Methodology	6
1.9 Population and Sampling Techniques	6
1.10 Type of Data Used	7
1.11 Method of Data Collection	7
1.12 Data Analysis Methods	8
1.13 Limitation of the Paper	8
1.14 Organization of the Paper	8
CHAPTER TWO Review of Related Literature	9
2.1. An Overview of SMEs	9
2.2. The Role of Micro and Small Enterprises MSEs in the Development Progress of a Country	12
2.2 Theoretical Framework	13
2.3. Common Characteristics of SMEs	14
2.4. Policy Framework for the Promotion of SMEs in Ethiopia	15
2.5. An Introduction, Nature and Importance of Working Capital.....	17
2.6. The Management of Working Capital and Success and Failure Factors of SME'	20

CHAPTER THREE PRESENTATION AND ANALYSSIS OF DATA.....	23
3.1 Background Characteristics of Respondents.....	23
3.1.2 Findings, Interpretation and Discussions.....	27
3.1.2.1 Trend of Using Working Capital Management.....	27
CHAPTER FOUR SUMMARY, CONCLUSION AND RECOMMENDATION.....	35
4.1 Summary.....	35
4.2 Conclusion.....	36
4.3 Recommendations.....	37
Reference.....	39
Appendix A	
Appendix B	

LIST OF TABLE

Table 3.1: Educational Status of Respondents	24
Table 3.2: Types Of Business Sectors The Respondents Involve.	25
Table 3.3: Respondents Sources of Start - Up Capital.....	26
Table 3.4: Cash Shortage Experience of Respondents	30
Table 3.5: Handling Cash Shortage Experience of respondent	30
Table 3.6: Effectiveness of Collecting Short-Term Credits by the respondent	31
Table 3.7: Trends of Effecting Payments	33

LIST OF FIGURE

Figure 3.1: Form of Ownership	25
Figure 3.2: Respondents Start - Up Capital	27
Figure 3.3: Trends of Financial Recording of the Respondents	28
Figure 3.4: Trends of Cash Budget Preparation by the Respondents.....	28
Figure 3.5: Trends of Growth Strategy Plan Preparation by the respondents	29
Figure 3.6: Effectiveness of Respondents Cash Budget Preparation	29
Figure 3.7: Trends of Credit Sales by the Respondents.....	31
Figure3.8: Trends of Credit Purchase by the Respondents	32
Figure3.9: Trends of Planned Use of Cash.....	32
Figure3.10: Trends of Borrowing from Lending Institutions.....	33

ABBREVIATION

A.D.L.I:	Agricultural Development led Industrialization
A.P.E.C:	Asia Pacific Economic Cooperation
C.S.A:	Central Statistical Authority
E.C:	European Commission
F.D.R.E:	Federal Democratic Republic of Ethiopia
F.E.M.S.E.D.A:	Federal Micro and Small Enterprises Development Agency
I.F.C:	International Finance Cooperation
I.C.O:	International Labor Organization
M.T.I:	Ministry of Trade and Industry
M.I.G.A:	Multilateral Investment Guarantee Agency
R.C.M.S.T.D.A:	Regional Micro and Small Enterprises Development Agency
S.M.E.S:	Small and Micro scale Enterprise
U.N.I.D.O:	United Nation International Development Organization
U.S.A.I.S:	United State Agency for International Development
W.C.M:	Working Capital Management

CHAPTER ONE

1.1 INTRODUCTION

A small and micro scale enterprise is a significant source of income to most nations. It provides job opportunities, wealth and societal well-being to the nations. It is endeavor that responsible for creating job opportunities for people. A small and micro scale enterprise has played an important role in the economic growth, innovation and competitiveness, and it may also play a role over time in poverty alleviation (Stimson, 2006). Small and micro scale enterprises (SMEs) are generally regarded as the engine of economic growth and equitable development in developing economies. Therefore, they regarded as the drivers of economy in most nations.

However, there are different determinants for the successful of small and micro scale enterprise development ranging from the individual level to country or local level. A small and micro scale enterprise in developing countries, especially in Ethiopia, is arguably the least studied significant economic and social phenomenon in the world today. As a result, this paper tries to investigating the impact of working capital management as a tool for the profitability of small and micro scale enterprise firms in Arada sub-city woreda 01. Hence, to attain its purpose the study explored literatures on the role of working capital management tool from international and national perspectives. The outcome of the study might be supposed to help as an input for small and micro scale enterprise firms in Arada sub-city woreda 01 ,local government of Arada sub-city wereda 01 Administration, for policy makers and for further scholars and researchers.

The paper is organized in four chapters, the first chapter is introduction contained the back ground of the study, statement of the problem, research objectives, research question, significance of the study, scope of the study, research design and methodology , limitation of the study and organization of the paper.

1.2 Background of the Study

Working capital management is a very important component of corporate finance because it directly affects the liquidity and profitability of the company. It deals with current assets and current liabilities. Excessive levels of current assets can easily result in a firm's realizing a substandard return on investment. However firms with too few current assets may incur shortages and difficulties in maintaining smooth operations (Horne and Wachowicz, 2000). Efficient working capital management involves planning and controlling current assets and current liabilities in a manner that eliminates the risk of inability to meet due short term obligations on the other hand and avoid excessive investment in these assets on the other hand (Eljelly, 2004).

Working Capital Management is a very sensitive area in the field of financial management also (Joshi, 1994). It involves the decision of the amount and composition of current assets and the financing of these assets. Current assets include all those assets that in the normal course of business return to the form of cash within a short period of time, ordinarily within a year and such temporary investment as may be readily converted into cash upon need.

Small businesses are viewed as an essential element of a healthy and vibrant economy. They are seen as vital to the promotion of an enterprise culture and to the creation of jobs within the economy. Small and micro sale Enterprises (SMEs) are believed to provide an impetus to the economic progress of developing countries and its importance is gaining widespread recognition. Equally in Ethiopia the SMEs occupy a central place in the economy. Currently, the existing 1.8 million SMEs are able to create jobs for only 2.2 million people.

Storey (1994) notes that small firms, however, they are defined, constitute the bulk of enterprises in all economies in the world. However, given their reliance on short-term funds, it has long been recognized that the efficient management of working capital is crucial for the survival and growth of small firms (Grablowsky, 1984; Pike and Pass, 1987). A large number of business failures have been attributed to inability of financial managers to plan and control properly the current assets and current liabilities of their respective firms (Smith, 1973).

The Working Capital Management of a firm in part affects its profitability. The ultimate objective of any firm is to maximize the profit. But, preserving liquidity of the firm is an important objective too. The problem is that increasing profits at the cost of liquidity can bring serious problems to the firm. Therefore, there must be a tradeoff between these two objectives of the firms. One objective should not be at cost of the other because both have their importance. If we do not care about profit, we cannot survive for a longer period. On the other hand, if we do not care about liquidity, we may face the problem of insolvency or bankruptcy. For these reasons, exercising working capital management should be given proper consideration and will ultimately affect the profitability of the firm.

1.3 Statement of the Problem

Working capital management is an important issue in any organization. This is because without a proper management of working capital components, it's difficult for the firm to run its operation smoothly. That is why Brigham and Houston (2003) mentioned that about 60 percent of a typical financial manager's time is devoted to working capital management. Hence, the crucial part of managing working capital is maintaining the required liquidity in day-to-day operation to ensure firms smooth running and to meet its obligation (Eljelly, 2004).

In addition, Most SMES do not care about their working capital position, most have only little regard for their working capital position and most do not even have standard credit policy. Many do not care about their financial position, they only run business, and they mostly focus on cash receipt and what their bank account position (Kehinde, 2011).

Furthermore, Kehinde(2011) noted that in management in working capital management of a firm especially the small and micro scale business, the acute shortage of fund needed for growth remain a subject of strategic financial management function.

Small and micro scale enterprise in Arada sub-city woreda 01 and in Ethiopia also shares the above poor exercise of working capital management. Various studies and government reports have stated that there is unprecedented level of exercising working capital management regarding on SMEs in Ethiopia.

In order to explain the relationship between working capital management and profitability different researches have been carried out in different parts of the world especially in developed countries.

However specific research studies exclusively on the impact of working capital management on corporate profitability of the small manufacturing companies in developing countries are insufficient, and have failed to attract the attention of researchers, particularly Ethiopia. Therefore, the researchers believed that, in Arada sub-city woreda 01 the problem is almost untouched and there is a knowledge gap on the area. In its effect most Ethiopian company's managers (SMEs) thought regarding working capital management is, to shorten (traditional views) to increase firm's profitability.

1.4 Research Question

Based on the stated specific objectives the following research questions were raised in the study:

1. What are the main causes of not using the system/tools of working capital management in SMES in Arada sub-city woreda 01?
2. How has been the trend of using working capital management in SMES in arada sub-city woreda 01?
3. What is the policy stance of local Government and the action taken towards on SMES in arada sub-city woreda 01?
4. What are the possible solutions to minimize the problem of of not using the system/tools of working capital management in SMES in arada sub-city woreda 01?

1.5 Objective of the Study

In order to address the statement of the problem the following general and specific objectives are coined.

1.5.1. General Objective

This study aims to describe the impacts of working capital management on profitability of firms of SMEs in Addis Ababa, Arada Sub- City.

1.5.2 Specific Objectives:

- 1 To identify the main cause of not using the system/tools of working capital management in SMES in arada sub-city woreda 01.
2. To find out the trend (extent) of using working capital management in SMES in arada sub-city woreda 01.
3. To examine governmental policies regarding on SMEs in on SMES in arada sub-city woreda 01.
4. To recommend some possible solution on how to reduce the problem of not using the system/tools of working capital management in SMES in arada sub-city woreda 01.

1.6. Significance of the Study

It is hoped that the result of this study concerning working capital management in the Addis Ababa would contribute to current knowledge on growth of small and micro scale enterprises. Secondly, the finding will be useful not only to small scale business in the Addis Ababa but also to all small- scale business throughout the country. Besides, the study helps as a guideline for those who conduct their study on similar topic and it gives brief information for the shareholders, prospective customers and creditors of a firm regarding profitability in relation to efficient working capital management and policy. This also will help stakeholders in business to formulate and implement policies that will help them to effectively manage working capital.

Moreover it could help to improve the book keeping and accounting practices in SMEs to facilitate growth, to help the SMEs gain access to finance and improve their financial management skills, and it could also help SMEs to adopt prudent managerial policies as well as professional expertise for efficient managerial works. Finally, this study will provide useful

information for designing strategies to influence the growth of small-scale enterprise, and benefits the researcher to obtain new knowledge about the problem under study and gives clear picture about the discipline.

1.7. Scope of the Study

Arada sub-city is one part of Addis Ababa. The sub-city has ten woreda. and there is so many small and micro enterprise . This implies that conducting a comprehensive study on all these MSEs is highly difficult at this level.

The study is therefore, a survey, and is limited to focus on assessment of working capital management on profitability of SMEs in Arada sub city woreda 01.

1.8 Research Design and Methodology

The study focused on the assessment of not using working capital management as a tool to maximize the profitability of small and micro scale enterprise' firms in Arada sub-city woreda 01. Thus the study was used descriptive in the sense that researches look at individuals, groups, institutions, methods, and materials in order to describe, compare, contrast, classify, analyze and interpret the entities and the events that constitute their various fields of enquiry. The major purpose of the study research was to describe the state of affairs at present. In descriptive method, you have no control over the variable, but you can only report what has happened or what is happening. To describe and evaluate their attitude on the role of exercising working capital management as tool for increasing profitability of small and micro scale enterprises', survey method was adopted. In the context of the study, survey method was obtaining reliable and relevant data as the study involves various subjects. In general, the method was believed to generate adequate data in breadth.

1.9 Population and sampling techniques

The appropriate study population for carrying out this investigation was basically all small and micro scale enterprise' firms in Arada sub-city woreda 01, officials concerned officials and employees from Arada sub-city woreda 01 small and micro scale enterprise' office. From those the accessible populations were the currently registered 88 small and micro scale enterprise', workers and officials in these offices.

The researcher employed different sampling techniques. Those were, proportional stratified sampling techniques for probability sampling method to collect data from small and micro scale enterprise. Because they were not homogenous. These sampling methods were more convenient and appropriate to assign the right representativeness from the non homogenous population. In addition, the researcher employed purposive sampling techniques for non-probability sampling techniques to select the right sample units from the workers and officials from target population to collect reliable data.

Based on this, in production 47.7 %, in trade 27.2 %, by service giving 25 % .From this total numbers the researcher selected 30 % sample size to increase quality of data by using a rule of thumb. By this method the result was 30. Because of using proportional stratified sampling techniques 14 in production, 9 in trade, 7 from service giving and 3 individual from expert and official of Arada sub-city woreda o1 trade and industry office.

1.10 Type of Data Used

This study was employed both primary and secondary data. The sources of primary data were the Small and micro scale enterprise list out for running business activities and concerned individual from expert and official of Arada sub-city woreda o1 small and micro scale enterprise office. The secondary data was gathered from published and unpublished documents from different organizations.

1.11 Method of Data Collection

Relevant and reliable data were non substitutable pillars of the study. Hence, with the aim of investigating the impact of not using working capital management as a tool to maximize the profitability the researcher was adopted the appropriate techniques used in relation to survey method: questionnaire and interviews.

Structured questionnaires were administered and they helped to rate the achievement, role and the impacts of not using working capital management as a tool to maximize the profitability of them. Structure or semi-structured interview was conducted to collect primary data.

1.12 Data Analysis Methods

Data from primary and secondary sources of the intended study was organized and classified according to the specific objectives of the study and research question was entered in to the computer. The organized and entered data was encoded and analyzed by the computer by using Microsoft excel .Descriptive statistics was used to interpret the findings information of the study.

The quantitative data was presented by using text, tables, figures, percentages and charts in order to display the information. The qualitative data was simply discussed, analyzed and presented qualitatively in a way it presents the information appropriately.

1.13 Limitation of the Paper

The main limitation of the study was absence of recorded data, reliable data and secondary source on well organized and with time up date data. On the other hand the unwillingness of small and micro enterprise owners, official and employers to respond in some questioner and interview, length of appointment, bureaucratic to respond question regarding to questioner and interview. This condition has required the data collecting team and the researcher to exert a great effort towards convincing the respondents about the fact that the survey is to be employed for academic purposes only and it will have no negative consequences on them from the any government office.

1.14 Organization of the Paper

The paper is organized in four chapters; the first chapter is introduction contained the background of the study, statement of the problem, research objectives, research question, significance of the study, and scope of the study, limitation of the study and research design and methodology. Chapter 2 also contained review of related literature. Chapter three presented presentation and analysis of data. And the last chapter presents summary, conclusion and recommendation for finding in the research paper.

CHAPTER TWO

Review of Related Literature

2.1. An Overview of SMEs

A) Definition and Scope

The term SMEs covers a wide range of definitions and measures, varying from country to country and between the sources reporting SMEs statistics. Some of the commonly used criteria are the number of employees, total net assets, sales and investment level. However, the most common definitional basis used is employment, and here again, there is variation in defining the upper and lower size limit of an SME (Meghana, Thorsten and Asli 2003). Financing agencies measure SMEs in terms of fixed assets; labor economists take the number of people engaged; traders might consider the volume of sale and manufacturers prefer to consider the energy use.

The first attempt to overcome problem of defining SMEs was given by the Bolton committee (1971 cited in Kayanula and Quartey 2000). According to the committee, a firm is regarded as small if it meets the following three criteria, such as, it has relatively small share of the market place, it is managed by owners in a personalized way management structure, it doesn't form part of a large enterprise.

The World Bank, USAID, and UNIDO also give alternative definitions. According to the World Bank (1976) firms with fixed assets (excluding) less than US 250,000 in value are small enterprises. According to USAID, firms with less than 50 employees are small while for UNIDO firms with 10 to 49 workers and have a registered capital of more than \$42,300 could be grouped in the category of small enterprises whereas Medium enterprises employ between 50 to 249 employees and have a registered capital of more than \$42,300 (Rana and Farah Tukan 2007).

The MIGA and the IFC define small enterprises as those that meet two of the following three conditions: Less than 50 employees, less than \$3 million total assets and less than \$3 million total annual sales. Unlike the EC definition, the MIGA and IFC definition does not consider the staff headcount threshold mandatory for an enterprise to qualify as an SME.

The most common criterion used within the economies of APEC is the number of employed personnel within the business itself, therefore, APEC defines SMEs as enterprises with less than 100 people, whereby, a medium sized enterprise employs between 20 and 99 people, a small firm employs between 5 and 19, and a micro firm employs less than 5 employees which includes self employed managers. According to this definition, 75% of enterprises in APEC were micro, 21% were small, and 4% were medium during the period between 1990 and 2000.

In recent times, there has been some degree of convergence in SMEs definitions particularly in Europe. The European Commission defines SMEs using a combination of employee numbers, annual turnover or balance sheet total and ownership as those enterprises that employ fewer than 250 people and have annual sales not exceeding \$67 million and/or total assets not exceeding \$56 million (Hillary, 2000). However, the above convergence does not in any way suggest a common agreement of the specific numbers in terms of these variables. To this end, different governments and writers in SMEs differ considerably. This difference is influenced largely by two factors.

B). Population and Stage of a Country's Economic Development.

A definition of SME in the developed world would differ from how SMEs is defined in the third world. Given the number of businesses in the United States of America (USA) and Europe, SMEs (if defined according to the number of employees and turnover) would be a definition adopted for large enterprise in Africa. For example, Fay (2000), Clarck (2000), the European Commission and the Organization for Economic Cooperation and Development (whose membership includes European and Asian countries like Japan) define SMEs as having below 250 employees. On the other hand, Ethiopia defines SMEs as having employees not exceeding 10 (CSA).

The second factor commonly used in defining SMEs is annual turnover. Again, the acceptable figures differ from country to country. For example, In the USA, the accepted definition of a small business is “an entity with average annual gross revenues for the preceding three years not to exceed \$15 million, and very small business as an entity with average annual gross revenues for the preceding three years not to exceed \$3 million” (Weaver, 1999). In Ethiopia, small

enterprises defined in their paid up capital which is more than Birr 20,000 (\$1,000) but not more than Birr 500,000 (\$25,000).

C). Industry within Which the SMEs Is Competing

Duncombe and Heeks (2001) categorized small enterprises into survivalist, trundlers and flyer classifications based on the industry with in which they are competing. Survivalists are defined as those enterprises, which have no choice, but to take up the income-generating activity because they have no other source of livelihood. The enterprise is mainly meant to keep the business owner alive. Income provided may be poverty line or even sub-poverty-line. They argue that most of „entrepreneurs' in less developed countries are of this type.

Trundlers are defined as those enterprises whose turnover is roughly static and who show no great desire or no great capacity to expand. Income provided will be enough to meet basic needs. They also argue that such enterprises form the second-largest group of small entrepreneurs in Less Developed Counties.

Flyers are defined as those true entrepreneurs who have taken up enterprise because they see opportunities for growth. Income levels may meet more than basic needs, and enterprises may graduate to the medium-scale category. Only a very small proportion of Less Developed Countries small entrepreneurs fall into this category.

D) The Ethiopian situation

The Central Statistical Authority of Ethiopia (2003) based its definition of SMEs on the size of employment and extent of automation for small scale enterprises and used a combination of these criteria for defining such enterprises. It defines small scale enterprises as “establishments engaging less than 10 persons and power driven machines” (CSA 2003:2). According to Andualem (1997), small scale enterprises are defined as business activities that are independently owned which are managed by the owner employing 6-49 persons.

Recognizing that there are no standard definitions of SMEs and that their definitions vary from country to country depending largely on the size of the economy, the levels of development,

culture and population size of a country involved, a working definition for the purposes of this paper is one given by the Ministry of Trade and Industry and Central Statistical Authority (CSA) which defines enterprises according to the number of employees and paid up capital. Ministry of Trade and Industry adopted official definition of Micro and a Small enterprise in Ethiopia is as follow: Micro enterprises are business enterprises found in all sectors of the Ethiopian economy with a paid-up capital (fixed assets) of not more than Birr 20,000, but excluding high-tech consultancy firms and other high-tech establishments. Small Enterprises are business enterprises with a paid-up capital of more than Birr 20,000 (\$1,000) but not more than Birr 500,000 (\$25000) but excluding high-tech consultancy firms and other high-tech establishments (MTI 1997, Zewde and Associates 2002).

2.2. The Role of Micro and Small Enterprises MSEs in the Development Progress of a Country

Nowadays, it has been recognized that SMEs play an important role in the economic growth process of developing countries and it is believed that the success or failure of a transition economy can be traced in large part to the performance of its entrepreneurs (McMillan & Woodruff, 2002).

The entrepreneurs of these SMEs do not only create income for their households and families, but they generate income and employment for their apprentices and workers leading to bottom-up transition out of poverty for entrepreneurs and workers (Sievers & Vandenberg 2007). Compared to large enterprises, SMEs are more labour intensive employing more labor per unit of capital than large enterprises (Kayanula & Quartey 2000). In addition to poverty alleviation, MSMEs contribute to the growth of a country by contributing welfare and generating wealth (higher incomes). The role of SMEs has also been emphasized in the context of achieving the United Nations Millennium Development Goals (MDG). Due to their small and perceived flexible nature MSMEs are expected to be able to withstand adverse economic conditions and survive where many large businesses would collapse (Aryeetey & Ahene, 2004). The flexible structure is also an advantage when it comes to adapting quickly to customers demands (Kayanula & Quartey 2000). It is further believed, that the formalization of informal business activities can contribute to increasing tax-incomes for the government and enable the

government in the long run to invest the money, for instance, in health care and education systems.

Small businesses are viewed as an essential element of a healthy and vibrant economy. They are seen as vital to the promotion of an enterprise culture and to the creation of jobs within the economy (Bolton Report, 1971). Small Medium-Sized Enterprises (SMEs) are believed to provide an impetus to the economic progress of developing countries and its importance is gaining widespread recognition.

E) Challenges and Constraints Generally Faced By SMEs In Developing Countries

There are a number of variables influencing the performance and business success of SMEs. The variables are interdependent and very often relate to each other.

2.2 Theoretical Framework

A) Business Characteristics of SMEs in Developing Countries

In developing countries, most business activities are very small, consisting very often of only one person. Since most enterprises are operating as one-person undertakings, the largest employment category is working proprietors (Mead & Liedholm 1998). Unpaid family members support in many cases the businesses. Trainees and apprentices add a significant share of workers in some location, particularly in West Africa.

Another common characteristic among SMEs is the fact that the majority of them operate in rural areas. Most of these rural enterprises are involved in manufacturing activities such as textiles and wearing apparel, food and beverages and wood and forest products. It has been observed, that there is a relationship between the possibility of expanding an enterprise and the location of the business: In contrast to their urban counterparts, rural enterprises are less likely to expand. The limited access and proximity to growing urban markets is the reason why rural enterprises encounter greater difficulties in terms of expanding and surviving (Mead & Liedholm 1998).

B) Challenges and Constraints

In order to operate successfully, SMEs have to overcome a number of obstacles which influence negatively the business performance. To set up a start-up enterprise, the entrepreneurs need to be able to get access to finance. The access to formal financial schemes is very often a constraint to SMEs and thus entrepreneurs are dependent on informal sources of finance such as own sources, family and friends or savings and credit associations (which charge high interest rates). Finance plays a critical role in all stages of the business life cycle and limits the ability of existing SMEs to expand and create jobs (Arthur, 2003).

SMEs very often begin small and eventually die small, without ever having seen any expansion in terms of employment numbers and output (Aryeetey & Ahene, 2004). MSMEs lack of the access to appropriate technology which they need to increase their profits and undertake upgrading (UNIDO, 2002). Appropriate technology means that it needs to be simple, effective, available, flexible, durable, efficient and cost effective (UNIDO, 2002).

Another problem, SMEs encounter is the access to markets. Very often MSMEs face serious difficulties when it comes to finding suppliers for the needed inputs and buyers for their products (Liedholm & Mead, 1998). The lack of information about market opportunities and standards and regulations is one of the underlying factors (Liedholm & Mead, 1998; Sievers & Vandenberg, 2007).

There are a high number of MSMEs closures due to a lack of demand and a shortage of working capital and this is why it is important to take these as constraining factors into account (Mead & Liedholm, 1998).

2.3. Common Characteristics of SMEs

- Born out of individual initiatives & skills
- Greater operational flexibility: Decision making such as changes in price mix or product mix in response to market conditions is faster.
- Low cost of production: SMEs have lower overheads. This translates to lower cost of production, at least up to limited volumes.

- High propensity to adopt technology: Traditionally SMEs have shown a propensity of being able to adopt and internalize the technology being used by them.
- High capacity to innovate export: SMEs skill in innovation, improvisation and reverse engineering are legendary. By being able to meet niche requirements, they are also able to capture export markets where volumes are not huge.
- High employment orientation: SMEs are usually the prime drives of jobs, in some cases creating up to 80%. Jobs SMEs tend to be labor intensive par se and are able to generate more jobs for every unit of investment, compared to their bigger counterparts.
- Utilization of locally available human & material resources: SMEs provide jobs locally and hence utilize manpower available locally.
- Reduction of regional imbalances: Unlike large industries where divisibility of operations is more difficult, SMEs enjoy the flexibility of location. The spread of SMEs is a fact which enhances their attraction from a national or regional policy.

2.4. Policy Framework for the Promotion of SMEs in Ethiopia

A) Policy Framework

The Derg (1974-1991) regime in its proclamation relating to commercial activities undertaken by the private sector (Proclamation No.76 /1975), limited the type and extent of private capital in the economy. In this legislation, restrictive measures such as the fixing of a ceiling on industrial capital (Br 200,000 for retail establishments, Br 300,000 for wholesale establishments, and 1 million for industry) were exercised. A one- man -one –license principle, provision of foreign, and bank loans, which favor state and organizations, and the biased practice against the private sector in extending loans, were practiced (Adugna 1997 and Gebrehiot 1997).

Following the over through of the Derg regime policies were enacted by the Government of Ethiopia to transform the previously command economy to a free market based economy and by so doing enhance the development of the private sector. Accordingly, the FDRE government has enacted a proclamation to provide encouragement, expansion and coordination of investment, because of this investment code those restrictive measures of the previous regime, have been

removed to encourage foreign and domestic investment in the productive sectors of the economy (Gebrehiot 1997, Adugna 1997 and Fantu 2001). In line with this, measures taken were the devaluation of the local currency, the privatization process, deregulation of prices, and mobilization of foreign currency and trade liberalization with the adoption of structural adjustment policy packages. Recently the Federal Democratic Republic of Ethiopia has launched an industrial development strategy, which is the current blueprint of a long-term industrial development (FDRE 2002). The overriding objective of the strategy is to promote development oriented private investment and industrialization in the country. There are major features that distinguish the strategy. Firstly, the emphasis on private investment as a promoter of industrial development is given due attention. Secondly, agriculture will take the leading role in the industrialization process. Thirdly, emphasis is given to labor intensive industries instead of those that are capital intensive. Fourthly, attention is given for facilitation of private investment through active involvement of both domestic and foreign investors. .Fifthly, the government will play strong economic governance as a strategy and lastly, promotion of active participation of the community in development is taken in to account. Most important in this initiative is the increased attention to selected types of industries in accordance with Agricultural Development Led Industrialization (ADLI) strategy. These industries include (i) textile and garment industries, (ii) beef and leather manufacturing industries, (iii) agro processing industries and (iv) construction industries.

To address the issue of the micro and small scale enterprise sector under the overall development strategy of ADLI the Federal Government of Ethiopia has launched a micro and Small Enterprises Development Strategy in 1997. The primary objective of this national strategy framework is to create an enabling legal, institutional, and other supportive environment for the growth and development of MSEs. The specific objectives of the strategy include among others facilitation of economic growth , bringing equitable development, creating jobs, strengthening cooperation between MSEs, setting the basis for medium and large scale enterprises ,promoting of export, balancing preferential treatment between MSEs and bigger enterprises. To achieve the objectives, it was assumed that supporting environment will be facilitated in areas of legal framework , regulatory conditions ,access to finance in the formal banking system and other micro and small enterprises focused financing institutions ,access to information, training ,skills

and management , appropriate technology, market as well as the physical infrastructure (MIT 1997). The role and significance of small manufacturing industries is also recognized and given due attention in the industrial development strategy (FDRE 2002).

Some researchers have indicated that through liberalization of trade, the local market is flooded with imported products. This created a very stiff competition and as a result, some enterprises had to close down. Besides, it was some authors contended that the devaluation of birr has pushed cost of production and prices of imported goods high and thus MSEs could not afford to buy raw materials, spare parts at exorbitant prices (Andualem 1997, Assefa 1997 and Fantu 2001).

B) Institutions

Institutions have been operating to promote the growth and development of SMEs. During the Derg regime, the former handicrafts and small scale industries development agency was active in the promotion of various industrial operations including carpet, garment manufacturing, furniture and metal fabrication.

Currently, to address the institutional support issues, the federal and regional micro and small enterprise agencies have been established, the responsibility being to efficiently and qualitatively promote the development of its beneficiaries by way of training, demonstrating prototype production activities and providing engineering design and consultancy services. According to the Micro and Small Enterprises Development Strategy ,the major organs to be involved in the implementation of the strategy are Ministry of Trade and Industry, regional trade and industry bureaus, Federal MSE Development Agency (FeMSEDA),Regional MSE development agencies (ReMSEDA), or the designated organs ,NGOs and private sector organizations (MTI 1997) .In addition, bilateral and donor assisted Programs like the ILO and GTZ-MSE development program are active stakeholders in the growth and expansion of the small enterprises in Ethiopia (Zewde and associates 2002).

2.5. An Introduction, Nature and Importance of Working Capital

Any industrial establishment requires broadly two kinds of funds. The first one is long-term funds which are required for the purchase of fixed assets such as land, building, machineries, purchase of furniture, purchase of vehicles and other items to bring the establishment into operation. The second kind is short-term funds. These are required to meet the needs of day-to-day expenses such as raw-materials, stores, power and fuel, salaries, wages, administrative expenses, interest, sales and distribution expenses and other expenses to produce the saleable goods, up to the realization of the sale proceeds.

Funds employed in current assets constitute working capital. It is in fact the „life-blood“ and controlling-nerve of the unit. The concept used for working capital may be gross working capital or net working capital. Gross working capital constitutes current assets, whereas net working capital means current asset minus current liabilities. Working capital, also known as net working capital, is a financial metric which represents operating liquidity available to a business. Along with fixed assets such as plant and equipment, working capital is considered a part of operating capital. It is calculated as current assets minus current liabilities. If current assets are less than current liabilities, an entity has a working capital deficiency, also called a working capital deficit.

The working capital meets the short-term financial requirements of a business enterprise. It is a trading capital, not retained in the business in a particular form for longer than a year. The money invested in it changes form and substance during the normal course of business operations. The need for maintaining an adequate working capital can hardly be questioned (Luo 1984). Just as circulation of blood is very necessary in the human body to maintain life, the flow of funds is very necessary to maintain business. If it becomes weak, the business can hardly prosper and survive (Horrigan 1965).

A company can be endowed with assets and profitability but short of liquidity if its assets cannot readily be converted into cash. Positive working capital is required to ensure that a firm is able to continue its operations and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses.

Many newly started units become sick or run into fatal problems due to defective financial plan. The plan adopted may fail to provide adequate capital to meet the needs of both fixed and working capital, particularly the later. There are instances where units have been able to obtain sufficient funds to buy a plant but failed to equip the same and conduct production operations successfully because of faulty assessment of working capital needs.

Amount of working capital required by the concerned unit may vary from time to time, depending upon various factors such as cost of raw material, utilization capacity, marketing arrangements etc. It is on account of this fact that entrepreneurs usually spend most of their time to manage working capital requirements.

A) Working capital management

Decisions relating to working capital and short term financing are referred to as working capital management. These involve managing the relationship between a firm's short- term assets and its short-term liabilities. The goal of working capital management is to ensure that the firm is able to continue its operations and that it has sufficient cash flow to satisfy both maturing short-term debt and upcoming operational expenses. Same basis as Capital Investment Decisions rather they will be based on cash flows and / or profitability. One measure of cash flow is provided by the cash conversion cycle - the net number of days from the outlay of cash for raw material to receiving payment from the customer. As a management tool, this metric makes explicit the inter-relatedness of decisions relating to inventories, accounts receivable and payable, and cash. Because this number effectively corresponds to the time that the firm's cash is tied up in operations and unavailable for other activities, management generally aims at a low net count.

Guided by the above criteria, management will use a combination of policies and techniques for the management of working capital. These policies aim at managing the current assets (generally cash and cash equivalents, inventories and debtors) and the short term financing, such that cash flows and returns are acceptable.

- Cash management. Identify the cash balance which allows for the business to meet day to day expenses, but reduces cash holding costs.

- Inventory management. Identify the level of inventory which allows for uninterrupted production but reduces the investment in raw materials - and minimizes reordering costs - and hence increases cash flow.
- Debtor's management. Identify the appropriate credit policy, i.e. credit terms which will attract customers, such that any impact on cash flows and the cash conversion cycle will be offset by increased revenue and hence Return on Capital (or vice versa).
- Short term financing. Identify the appropriate source of financing, given the cash conversion cycle: the inventory is ideally financed by credit granted by the supplier; however, it may be necessary to utilize a bank loan (or overdraft), or to "convert debtors to cash" through "factoring".

2.6. The Management of Working Capital and Success and Failure Factors of SME'

The management of working capital is important to the financial health of businesses of all sizes. Efficient management of working capital is a fundamental part of the overall corporate strategy in creating the shareholders' value. Firms try to keep an optimal level of working capital that maximizes their value (Deloof, 2003; Howorth and Westhead, 2003 and Afza and Nazir, 2007).

The amounts invested in working capital are often high in proportion to the total assets employed and so it is vital that these amounts are used in an efficient and effective way. However, there is evidence that small businesses are not very good at managing their working capital. Given that many small businesses suffer from under capitalization, the importance of exerting tight control over working capital investment is difficult to overstate. While the performance levels of small businesses have traditionally been attributed to general managerial factors such as manufacturing, marketing and operations, working capital management may have a consequent impact on small business survival and growth (Kargar and Blumenthal, 1994).

From the perspective of Chief Financial Officer (CFO), working capital management is a simple and straightforward concept of ensuring the ability of the organization to fund the difference between the short-term assets and short-term liabilities (Harris, 2005). However, a „Total

approach is desired as it can cover all the company's activities relating to vendor, customer and product (Hall, 2002). In practice, working capital management has become one of the most important issues in the organizations where many financial executives are struggling to identify the basic working capital drivers and an appropriate level of working capital (Lamberson, 1995). Consequently, companies can minimize risk and improve the overall performance by understanding the role and drivers of working capital management.

A firm may adopt an aggressive working capital management policy with a low level of current assets as a percentage of total assets, or it may also be used for the financing decisions of the firm in the form of high level of current liabilities as a percentage of total liabilities. Excessive levels of current assets may have a negative effect on the firm's profitability, whereas a low level of current assets may lead to a lower level of liquidity and stockouts, resulting in difficulties in maintaining smooth operations (Van Horne and Wachowicz, 2004).

The main objective of working capital management is to maintain an optimal balance between each of the working capital components like average collection period, average payment period and cash conversion cycle. Business success heavily depends on the financial executives' ability to effectively manage receivables, inventory, and payables (Filbeck and Krueger, 2005). Firms can reduce their financing costs and/or increase the funds available for expansion projects by minimizing the amount of investment tied up in current assets. Most of the financial managers' time and efforts are allocated towards bringing non-optimal levels of current assets and liabilities back to optimal levels (Lamberson, 1995). An optimal level of working capital would be the one in which a balance is achieved between risk and efficiency. It requires continuous monitoring to maintain proper level in various components of working capital, i.e., cash receivables, inventory and payables, etc.

In general, current assets are considered as one of the important components of total assets of a firm. A firm may be able to reduce the investment in fixed assets by renting or leasing plant and machinery, whereas the same policy cannot be followed for the components of working capital. The high level of current assets may reduce the risk of liquidity associated with the opportunity cost of funds that may have been invested in long-term assets.

Working capital management (WCM) is of particular importance to the small business. With limited access to the long-term capital markets, these firms tend to rely more heavily on owner financing, trade credit and short-term bank loans to finance their needed investment in cash, accounts receivable and inventory (Sacurato, 1994; Chittenden 1998).

However, the failure rate among small businesses is very high compared to that of large businesses. Studies in the UK and the US have shown that weak financial management - particularly poor working capital management and inadequate long-term financing - is a primary cause of failure among small businesses (Berryman, 1983; Dunn and Cheatham, 1993). The success factors or impediments that contribute to success or failure are categorized as internal and external factors.

The factors categorized as external include financing (such as the availability of attractive financing), economic conditions, competition, government regulations, technology and environmental factors. While the internal factors are managerial skills, workforce, accounting systems and financial management practices.

Working capital starvation is generally credited as a major cause of small business failure in many developed and developing countries (Rafuse, 1996). The success of a firm depends ultimately, on its ability to generate cash receipts in excess of disbursements.

The cash flow problems of many small businesses are exacerbated by poor financial management and in particular the lack of planning cash requirements (Jarvis et al, 1996).

Some research studies have been undertaken on the working capital management practices of both large and small firms in India, UK, US and Belgium using either a survey based approach (Burns and Walker, 1991; Peel and Wilson, 1996) to identify the push factors for firms to adopt good working capital practices or econometric analysis to investigate the association between WCM and profitability (Shin and Soenen, 1998; Deloof, 2003).

Specific research studies exclusively on the impact of working capital management on corporate profitability of the small manufacturing companies are scanty, especially for the case of Ethiopia.

The financial management of small firms in developing countries and in particular, Ethiopia, is altogether an ignored area of research.

This study, therefore, attempts to assess the impact of WCM on profitability of a sample of small manufacturing companies In Addis Ababa and its results are expected to contribute to the existing literature on working capital and SMEs.

CHAPTER THREE

PRESENTATION AND ANALYSIS OF DATA

This chapter deals with research data obtained from the field. It contains the analysis parts, which deals with the interpretation of the data obtained from primary and secondary sources. The primary data was collected through questionnaires and interviews. The questionnaires were distributed for the selected sample respondent. Except eight, all of the distributed questionnaires were and returned for analysis, In addition to this, 3 response from arada sub-city woreda 01 small and micro scale enterprise office's participants were included. 33 respondents were considered for the study. Therefore in order to make clear the obtained information's were tabulated, organized and followed by using qualitative and descriptive statistical methods and presented by percentage, charts and tables to facilitate the interpretation of the results and come up with main findings.

3.1 Background Characteristics of Respondents.

An analysis of the background of respondents depends on information collected from arada sub-city woreda 01 small and medium scale enterprise and arada sub-city woreda 01 small and medium scale enterprise office's expert and official. From the total sample size, 30 samples were small and micro scale enterprise and 3 sample employees (officials and experts) were involved in the study. A total, of 33 questionnaires were distributed to the above mentioned respondents 3 were missed and 30 returned back and its response rate is 91%. In addition the response of 3 participants from small and micro enterprise Office was included. As it was mentioned earlier the sample includes both small and micro scale enterprise and office's expert and official. They were relevant source of data regarding the issues.

From the composition of the respondents, the majority of the respondents 67% were males while the remaining 33% were covered by female respondents. Thus, from the result it was possible to say that the study could not incorporate views of both sexes fairly.

All the thirty (30) sample individuals in this research are category-C tax payers. None of them has a well designed record keeping system in accordance with GAAP. But some of them

maintain a record of their income and expenses in a very traditional manner. Therefore, they don't prepare Income Statement and Balance sheet, owner's equity and cash flow statements. Accordingly financial statements and inventory management are not included in the study.

The researchers have stated above, they don't have any acceptable recording system and hence they cannot produce any financial statements. Due to this scenario, they pay profit tax annually and 2% turnover tax based on monthly sales estimate prepared by the tax authority to each business sector. These are the basic points that have to be raised in here. The types of data we have collected include the followings:

3.1.1.1 Educational Statuses of Respondents

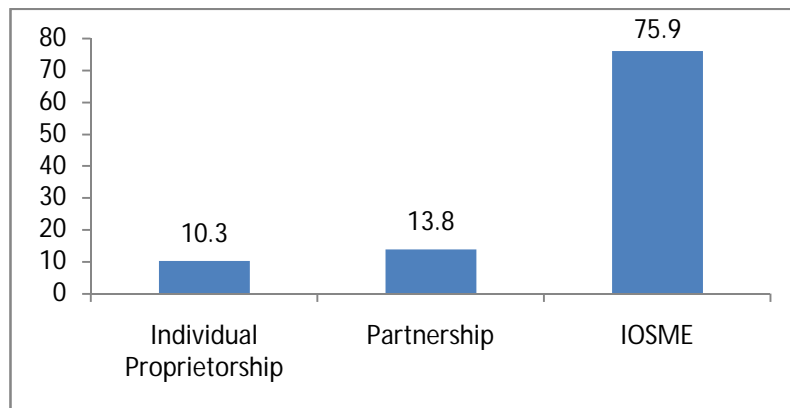
Table 3.1: Educational Status of Respondents

Educational status of respondents	Frequency	Percent
Twelve Complete	17	58.6
Preparatory Complete	6	20.7
College Diploma	7	20.7
Total	30	100.0

Source: Field Survey, 2014.

Table 3.1 indicate that most of the respondents; twelve complete which accounts 58.6 percent and, the remaining 41.4 percent was preparatory complete and college diploma at equal amount 20.7 percent .

Figure 3.1: Form of Ownership



Source: Field Survey, 2014.

The above figure shows that; the majority (75.9%) of the business owners are those individuals who are organized under small & microfinance enterprise (IOSME). And the second form of ownership was Partnership which accounts 13.8%. Finally sole proprietorship is the least (10.3%) type of form of ownership.

3.1.1.3 Types of Business Sectors

Table 3.2: Types Of Business Sectors The Respondents Involve.

Type of Sector of the business	Frequency	Percent
Trade	7	24.1
Service	8	24.1
Production	15	51.7
Total	30	100.0

Source: Field Survey, 2014.

Table 3.2 indicate that most of the business organizations were engaged in the production sector of the business (51.7%) and involved in trade and service sectors share the rest 48.3 % at equally 24.1 % .

3.1.1.4 Sources of start - up capital

In this study small and micro scale enterprise have different financial source to start and Cary out the business activities. This source was presented below from field survey.

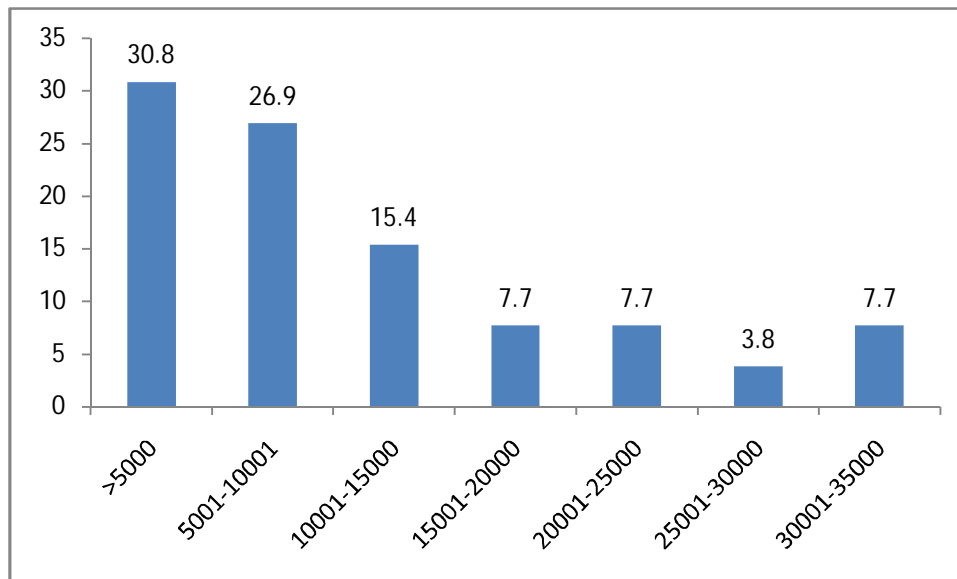
Table 3.3: Respondents Sources of Start - Up Capital

Source of Starting up Money	Frequency	Percent
Personal Saving	11	36.7 %
Friend and relatives	2	6.7 %
Micro-finance institution	14	46.7 %
From “equb” saving	2	3.3 %
Borrowing from Bank	1	6.7 %
Total	30	100 %

Source: Field Survey, 2014.

The above table shows the sources of funds to start a new business. According to this study most of small and medium scale enterprise (46.7%) was financed by Small & Micro-finance institutions during their establishment. The study also shows that personal saving is the second source of finance which constitutes (36.7%) of the total. The remaining 13.4 percent of the business are financed either by friends and relatives or lending from banks. Finally ‘equib ‘ is the least source of fund which constitutes only 3.3 percent of the other means of financing.

Figure 3.2: Respondents Start - Up Capital



Source: Field Survey, 2014.

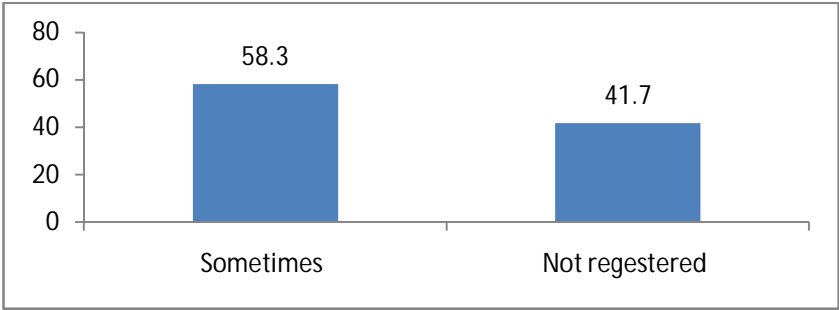
3.1.2 Findings, Interpretation and Discussions

In this section the major findings of the impact of not using working capital management as a tool to maximize the profitability of small and micro scale enterprise' firms in Arada sub-city wereda o1were presented and discussed below by relating it with the literature reviews that can show the gaps.

3.1.2.1 Trend of Using Working Capital Management.

In this section the study sought to capture respondents' opinion on the impact of not using the working capital management as a tool to maximize their profitability. The results obtained from the field survey were present below.

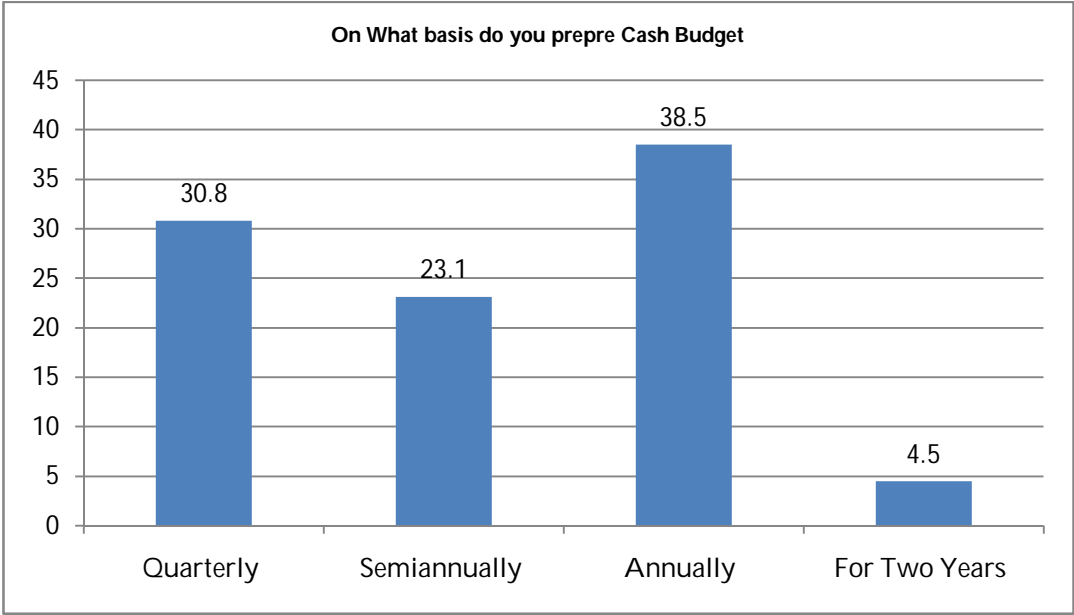
Figure 3.3: Trends of Financial Recording of the Respondents



Source: Field Survey, 2014.

The question of having any financial recording system relation to business making activities was posed to the respondents. Accordingly, as shown in the above figure 3.2 stated that (58.3 percent) of the respondents use financial recording system sometimes. On the other hand, the rest 41.7 percent of the respondents did not have any financial recording system.

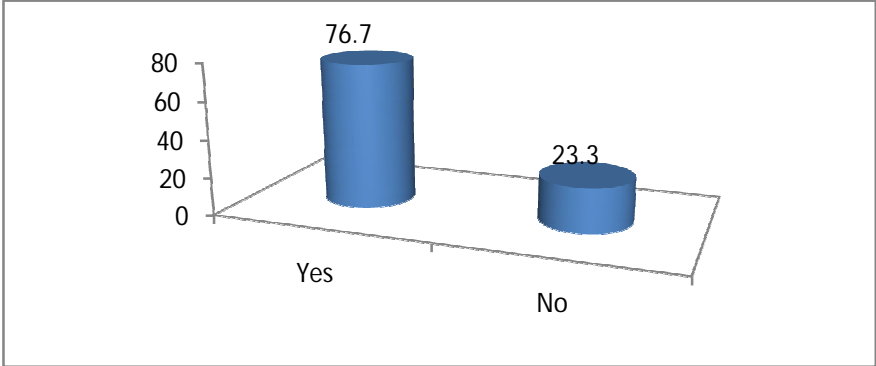
Figure 3.4: Trends of Cash Budget Preparation by the Respondents



Source: Field Survey, 2014.

According to the above figure, 38.5 percent of the respondents said that they prepare Cash budget annually and followed by those who prepare quarterly (30.8 Percent).

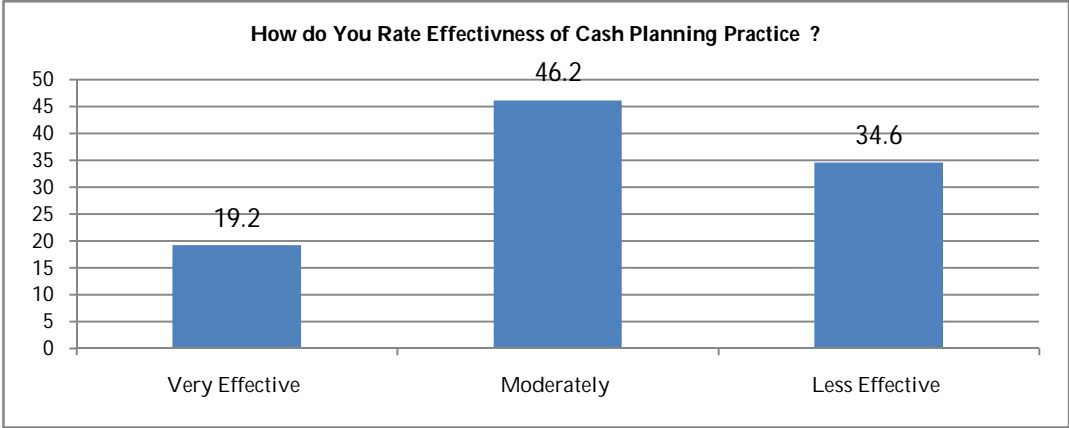
Figure 3.5: Trends of Growth Strategy Plan Preparation by the respondents



Source: Field Survey, 2014.

As it can be seen from figure 3.4, Most of the respondent which constitutes 76.7 percents have growth strategy. Besides 23.3 percent of the respondents did not have growth strategy.

Figure 3.6: Effectiveness of Respondents Cash Budget Preparation



Source: Field Survey, 2014.

According to the respondents 46.2 percent responded that their cash managing practice is moderate.

Table 3.4: Cash Shortage Experience of Respondents

<i>Have you ever experienced cash shortages before?</i>	<i>Frequency</i>	<i>Percent</i>
always	3	10.3
usually	15	51.7
rarely	9	31.0
never	3	6.9
Total	30	100.0

Source: Field Survey, 2014.

According to the above frequency and percentage distribution table we can easily see that most of the business organization owners usually experience cash shortage (51.7 percent). 10.3 % of the business owners always experience cash shortage. Only 31% of the organizations rarely experience cash shortage

Table 3.5: Handling Cash Shortage Experience of respondent

<i>would you please explain how your company handles cash shortages</i>	<i>Frequency</i>	<i>Percent</i>
long term loan	16	55 %
Short term loan	14	45 %
Total	30	100 %

Source: Field Survey, 2014.

Based on the above frequency and percentage distribution table business organizations solve their cash shortage problem by taking long and short terms loan which is about 55 and 45 percent respectively.

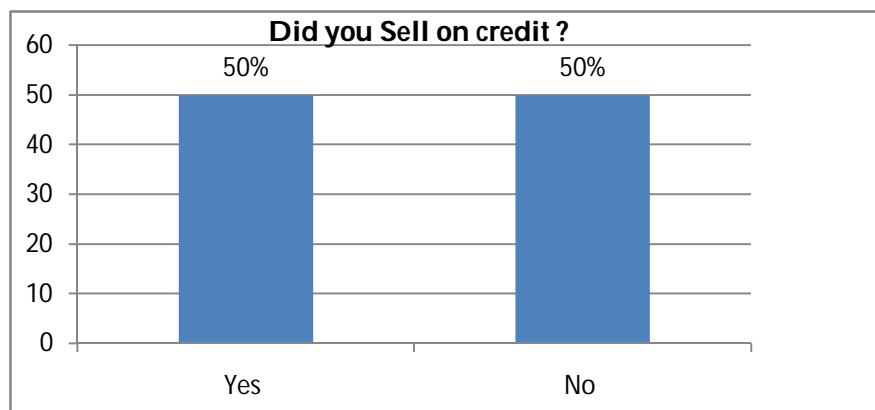
Table 3.6: Effectiveness of Collecting Short-Term Credits by the respondent

<i>Effectiveness of your organization on collecting short term credit</i>	<i>Frequency</i>	<i>Percent</i>
very good	9	40 %
Low	5	20 %
moderate	7	28 %
Very low	1	4 %
It is not enough	2	8 %
Total	30	100.0

Source: Field Survey, 2014.

The above frequency and percentage distribution shows that 40 percent of the organization responded that their short term credit collection is very good. Followed by those organization who responded their effectiveness of collecting credit from their customer is moderate (28 percent). Those who responded the collection trend of short term credit from their customers is low i.e. 20 percent the remaining 8 percent is very low of the total.

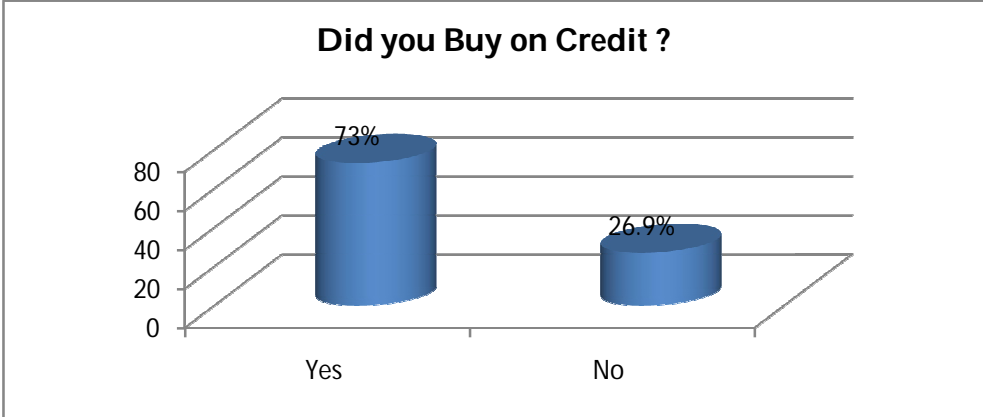
Figure 3.7: Trends of Credit Sales by the Respondents



Source: Field Survey, 2014.

As the above figure show, exactly half of the business organization sells by credit and the other half of them did not sell by credit. Thus, based on the above descriptive graph there is no majority in either case.

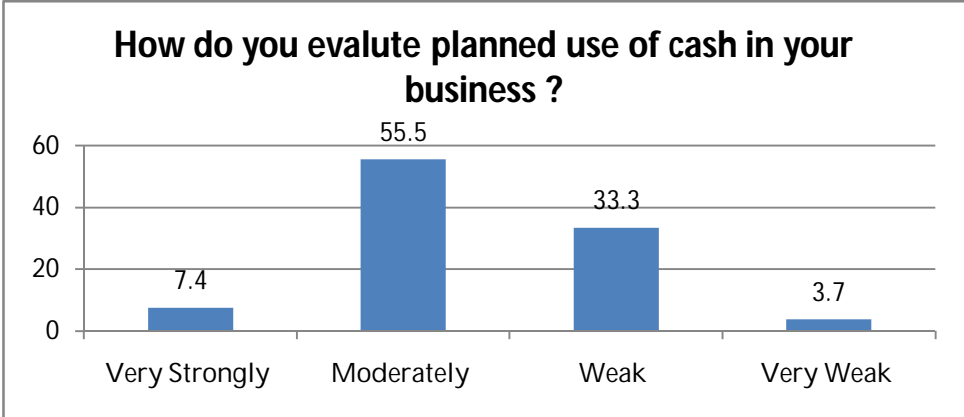
Figure3.8: Trends of Credit Purchase by the Respondents



Source: Field Survey, 2014.

Majority (73%) of the business organization owners responded that they buy input for their organization on credit. On the other hand 26.9 % of them said that they did not buy input for their organization on credit.

Figure3.9: Trends of Planned Use of Cash



Source: Field Survey, 2014.

55.5 percent of the respondents said that planned use of cash moderately exist in their business organization. Followed by those who responded the planned use of cash is weak in their organization.

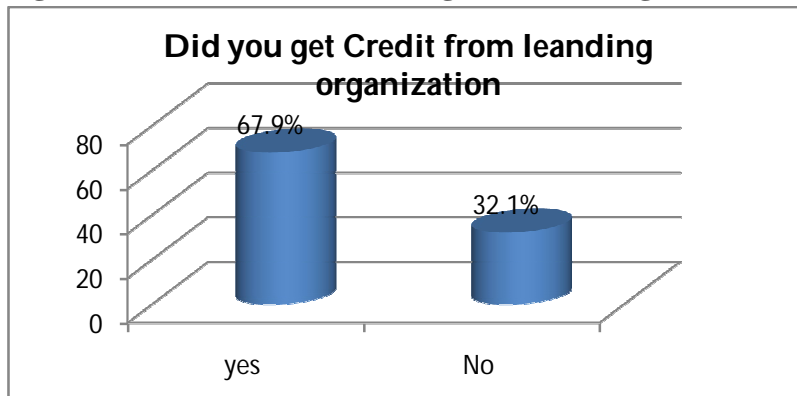
Table 3.7: Trends of Effecting Payments

How does your company effect cash payment	Frequency	Percent
By Check	2	8 %
By Cash	23	92 %
Total	30	100 %

Source: Field Survey, 2014

According to the above table most of the organization cash payment is by cash which constitute 92 percent and followed by those organization who paid by check (8%).

Figure3.10: Trends of Borrowing from Lending Institutions



Source: Field Survey, 2014

As the above graphs shows 67.9 percent of business organizations get credit from lending institution or organization. On the other hand, 32.1 percent of the business organization did not get credit from lending organizations.

In this section the study shows that, most SMEs lack standards hence, no proper assessment of their performances. This creates opportunity for mismanagement and eventually leads to the downfall of the establishment.

An interview with the small and medium enterprise Office Head of woreda 01 reply that the enterprise were always dependent .even they don't tries their business activities and they also use miss-utilization of government help. Government will continue to facilitate training and credit facilities to MSE operators. Short-term training in different business and vocational activities as well as cooperation with ACSI will be extended. A special attention will be given for strengthening cooperation between the MSE sector in wood and metal business types and the agricultural sector in the production of different improved implements to the later.

In the previous section, the survey found that the MSEs in woreda 01 encounter various challenges to operate normally as well as to expand operation. Particularly, financial and premises-related problems seem much stronger than others.

In general, one can observe from the above presentation in this section that MSEs are likely to have a bright future and favorable prospects to contribute to the economy. The condition of the economy, the potentials of the sector and the policies and strategies surely provide a bright future of MSEs. However, the only 'written' policies and strategies for the sector have to come and be converted to action, and serious attempts should be made to tackle the serious challenges. In short, the paper agrees on the bright and good prospects of small and medium enterprise Office.

CHAPTER FOUR

Summary, Conclusion and recommendation

4.1 Summary

This research is conducted to provide empirical evidence about the effects of working capital management on the profitability of a sample of small and micro enterprise.

A small and micro scale enterprise has played an important role in the economic growth, innovation and competitiveness.

They also regarded as the drivers of economy in most nations.

There are different determinants for the successful of small and micro scale enterprise.

To find out the determinants, the research approach adopted in the study both qualitative and quantitative research strategy.

The researchers was adopted the appropriate data collection instruments, such as questionnaire and interviews.

The researchers were adopted probability and non probability sampling techniques.

From the total population, a sample of 30 S.M.Es was taken from different sectors. Accordingly we have summarized below the findings.

- 51.7% of the individuals who have their own business are involved in the production sector of the economy where as the rest are either traders or engaged in rendering services
- Majority of these business owners are twelve complete .individuals organized under small and microfinance enterprises is the type of Ownership preferred by such business men.
- Most of such businesses are financed by micro-finance institutions and personal Savings are the second most source of fund used during their establishment.
- The study has also indicated that the majority of such business owners have started their business with a capital of 5,000 birr.

- Needless to mention that growth strategy is a back bone of any business, however our study shows that only 76.7% of the organizations have a well planned growth strategy.
- Only 30.8% of them prepares their cash budget quarterly.
- Only 19.2% of them has a very effective cash planning practices.
- 51% of them usually face a cash shortage problem 10.3 %of always face a cash shortage problem.
- Only 31% of them rarely face a cash shortage problem.
- 55% of them solve their cash shortage problem with a long term loan and the remaining 45% solve their cash shortage problem with a short term loan.
- Almost all (92%) of them effect payments on cash.
- Almost 68% of them can get credits from lending institution.
- The majority of them (73%) have a custom of buying on credit.
- None of them has acceptable record keeping system. This prevents them from knowing their income and expenses. Besides most of them do not separate their business income and expense from their personal income and expenses.

4.2 Conclusion

The study was conducted mainly to dig out those major problems of small and micro scale enterprise that are bottlenecks and obstacles to operate and expand their activities, and also to provide a prospective analysis about their future development. Provision of an overview on their contribution to the economy and recommending alternative solutions were also initially taken as objectives of the study.

The result of the survey shows that undertaking of related vocational/ technical training is a rare phenomenon. This is attributed mainly to lack of access to the training. The majority of the sample small and micro scale enterprise operators have not taken credit in an attempt to expand their business mainly due to fear of bankruptcy and high interest payment. The major sources of their borrowings were micro finance institution, however it is not that much beneficial for expansion.

According to the survey, in overall business management, poor record keeping, technical problems/competence and lack of essential and required expertise in production, procurement,

maintenance, marketing, finances, Lack of trained manpower and management skills also constitute a major challenge to the enterprise. This always led to funds misapplication, wrong and costly decision making.

The survey study conducted also reveals that shortage of capital was the first most severe constraint of the operators to carry out the business. It could be created because the formal banks are reluctant to avail credit facilities to small and micro scale enterprise and lack of knowledge about available financing programmes or the process of application. Inadequate/ inappropriate business premises and socio-cultural problems were also identified as second and third most severe carrying out the business activities challenges. The former could emanate from the inability of the government to construct sufficient commercial premises intensified by the land acquisition policy, and the later due to lack of awareness, traditional way of business activities, miss managerial skills and not good attitude of the community towards some business activities.

Finally, after having a glance at the condition of the economy, the potential of the small and micro scale enterprise sector, the policies designed and on the strength of the problems and obstacles being and may be encountered, the survey has found that the small and micro scale enterprise in Addis Ababa will have a bright future provided that sound measures are taken.

4.3 Recommendations

Unless quick and sustainable solutions are given, MSEs are very vulnerable and sensitive to various and severe constraints which could prevent them from playing their indispensable roles in economic development. The following are recommended in order to solve the major problems and obstacles identified by the survey study:

1. Shortage of capital : To overcome this problem:

- ✚ The concerned body should promote the establishment as well as the growth of micro finance institutions that are able to provide credit to MSEs at reasonable interest rates. In this regard, working in collaboration with ACSI needs to be emphasized;
- ✚ MSEs borrowers have to have the information and knowledge about banking systems and services and their procedures;

- ✚ Above all, persuading and promoting the community to save more for the creation of investment capital should be given too much emphasis.
2. **Lack of/ inadequate skill** : This problem is mainly due to lack of training, and hence
- ✚ Sustainable training based on MSE operators' interest need to be provided mainly in the areas of business management, entrepreneurship development, accounting and specific technical skills;
 - ✚ The local government's MSE Coordinating Office have to promote NGOs, the Chamber of Commerce, interested individuals and other stakeholders both in the provision of trainings and sharing of their expenses.
 - ✚ Working capital is the life blood and nerve center of business. Working capital is very essential to maintain smooth running of a business. No business can run successfully without an adequate amount of working capital. The small and micro scale enterprise sector should exercise Working capital management. It helps to operate the business smoothly without any financial problem for making the payment of short-term liabilities. Purchase of raw materials and payment of salary, wages and overhead can be made without any delay. Adequate working capital helps in maintaining solvency of the business by providing uninterrupted flow of production.

In general, there should be a strong integration and cooperation among government bodies themselves and between other stakeholders. The policies for MSE sector development should come to practice rather than serving only as cosmetics. The private sector needs to be at the forefront in the provision of various business development services. Economists, planners, policy makers, sociologists, psychologists and others have to get together and work hard to expand/develop the sector by mitigating the problems properly.

REFERENCES

- Andualem Tegegne (1997). **Small Scale Enterprise and Entrepreneurship Development in Ethiopia.**
- Arthur, D (2003). *Private Sector Development and Poverty Reduction* in Nigeria.
- Aryeetey and Ahene (2004). **Small-scale industry's Contribution to Economic Development, In Gender, small-scale Industry and Development policy**, Baud and Bruijne (eds), IT Publications, London.
- Berryman J. (1983). **Small Business Failure and Bankruptcy A survey of the Literature** *European Small Business Journal.*
- Brigham and Houston (2003). *Small-Scale Enterprise Development Strategy.*
- Burns R and Walker J. (1991). **A Survey of Working Capital Policy among Small Manufacturing Firms** *the Journal of Small Business Finance.*
- Bolton, Report (1971). *Handicraft Manufacturing Industries Survey Kenya.*
- Central Statistical Authority (CSA) Ethiopia (2001). **Analytical Report at National Level** *the Report on Small Scale Manufacturing Industry Survey* Addis Ababa Ethiopia.
- Deloof D. (2003). **Does Working Capital Management affects Profitability of Belgian Firms?**
- Duncombe and Heeks (2001). *Analyzing the policy Framework for small Enterprises Development. In Small Enterprises and changing Policies* IT Publications London.
- FDRE-MOFED (2002). *Sustainable Development and Poverty Reduction Programme* Federal Democratic of Ethiopia (FDRE) Ministry of Finance and Economic Development (MOFED) Addis Ababa.
- Fay, Clark (2000). **Small and Medium-Sized Enterprises and the Environment An Empirical Investigation in Turkey.**
- Filbeck and Krueger (2005). *The Role of Small-scale Industries in the Industrialization of the Ethiopian Economy*, LONDON.
- Gebrehiot Agaba (1997). **An Analysis of Financial Sector and Credit Policies during the Derg Period and Post Derg Reforms.** *Ethiopian Journal of Economics.*
- Grablowsky, B. J. (1976). **Mismanagement of Accounts Receivable by Small Business** *Journal of Small Business.*

- Grablowsky, Pike and Pass (1987). **Introduction to Development Economics Routledge London.**
- Harris, A. (2005). **Working Capital Management Difficult, but Rewarding Financial Executive Vol. 21.**
- Hillary, R.(2000).**Small and Medium-Sized Enterprises and The Environment Sheffield.**
- Hall, W(2002). *Private Sector Development and Poverty Reduction in Nigeria.*
- Joshi, A.(1994). ***The Role of Micro Enterprises in Development Economic Impact.***
- Horrigan, K.(1965). *Markov-Perfect Industry Dynamics a Framework for Empirical Work Review of Economic Studies.*
- Kargar, J and Blumenthal, R. A. (1994). **Leverage Impact on Working Capital in Small Business.**
- Kehinde, G.(2011). ***Small-Scale Enterprise Development in Ethiopia EEA Addis Ababa.***
- Kayanula and Quartey 2000). *Small Business Enterprise. (How to start and succeed). Benin City Benin Social Series for Africa. Enlarged Edition.*
- Lamberson, M. (1995). **Changes in Working Capital of Small Firms in Relation to Changes in Economic Activity *Mid-American Journal of Business.***
- Liedholm and Mead, (1998). *Small Firms and Their Helpers Lessons on Demand World Development.*
- McMillan and Woodruff (2002). ***Small and Medium Enterprises in Transitional Economies.***
- Mead and Liedholm (1998). ***The Links Between Small-scale and Large-scale Industries in INDIA.***
- Wilson, N. (1996). **Working Capital and Financial Management Practices in the Small Firm Sector.**
- Rafuse, J. (1996). ***Small-scale industry's Contribution to Economic Development .***
- Stimson, R. Stough, R. and Roberts, B. (2006). ***Regional Economic Development Analysis and Planning Strategy (2nd ed). Springer Austria.***
- Storey, D. J. (1994). **Understanding the Small Business Sector. London Routledge.**
- Smith, M. Beaumont, Begemann, E. (1997). **Measuring Association between Working Capital and Return on Investment *South African Journal of Business Management Vol. 2***

Shin, HH Soenen L. (1998). **Efficiency of Working Capital Management and Corporate Profitability.** *Financial Practice and Education.*

Saccurato and Chittenden (1998). *Marketing Strategies for Small Business under SAP. Business.*

Sievers and Vandenberg (2007). *Strategic Management of Small and Medium Scale Industries.*

UNIDO (1993). **Industry in the Least Developed Countries Structure and Development Vienna.**

Van Horne, J C and Wachowicz J. M. (2004). **Fundamentals of Financial Management (12th Edition), Prentice Hall Publishers. New York.**

Weaver, F. (1999). *Support Mechanism for Small Enterprises in Transition Economies,* World Association of Industrial and Technological Research Organizations.

Zewde and Associates (2002). **Women Entrepreneurs in Ethiopia, Jobs Gender, and Small Enterprises in Africa. Women Entrepreneurs in Ethiopia ILO Office Addis Ababa.**

APPENDIX : A
Research Questionnaires
St. Mary's University

This questionnaire is designed to obtain information about assessment of working Capital Management on Profitability of small and Micro Scale enterprises. The information you are going to provide will be used purely for academic purpose. Therefore, you are kindly requested to give genuine response.

Thank you in advance for your cooperation

Part One: Background Information

1. Sub city _____
2. Woreda _____
3. When did you start this business? _____
4. Educational level of the respondents
 - A. Twelve Complete
 - B. Preparatory complete
 - C. College Diploma
 - D. Degree
 - E. Above Degree
 - F. If other please specify _____
5. What Sector is your business in?
 - A. Trade
 - B. Service
 - C. Production
 - D. If other Please specify _____
6. Form of ownership
 - A. Individual proprietorship
 - B. Partnership
 - C. Share company
 - D. Private Limited
 - E. If other Please Specify
7. How many employees do you have in your business enterprise?

Part Two: Information on Entrepreneurial Capacity, Resources for Start up.

8. How much did it cost you to set up the business? _____

9. What was your main source of startup founding?
- A. Person Saving
 - B. From Household
 - C. Micro-finance institutions
 - D. From equb saving
 - E. Borrowed from Bank
 - F. Assistant from NGO's
 - G. Inheritance money
 - H. Borrowed from relatives or friends
 - I. If other Please specify _____
10. Did you get a support from governmental or non-governmental organization?
- A. Yes
 - B. No
11. What were the three biggest obstacles you face in developing or doing business?
- A. Lack of confidence to take riskier business
 - B. Lack of adequate working capital
 - C. Lack of managerial skill
 - D. Problem of working space or sales outlet
 - E. If other please specify _____

Part Three: Questions Related With Cash Management Practices

12. Do you keep your enterprise money separate from your personal money?
- A. Yes
 - B. No
13. Do you have a growth strategy?
- A. Yes
 - B. No
14. Do you incorporate cash budget in the growth strategy?
- A. Yes
 - B. No
15. If your answer is yes on question 15 above what basis do you prepare cash budget?
- A. Monthly
 - B. Quarterly
 - C. Semi annually
 - D. Annually
 - E. For two years

- F. If other please specify _____
16. How do you rate the effectiveness of cash planning practice in your company?
- A. Very effective
 - B. Moderately effective
 - C. Less effective
 - D. Very less effective
 - E. Not effective
17. Have you ever experienced cash shortages before?
- A. Yes always
 - B. Yes usually
 - C. Yes rarely
 - D. No never
18. If your answer for the above question is yes, would you please explain how your company handles cash shortages? _____
19. Have you ever experienced cash surplus before?
- A. Yes always
 - B. Yes rarely
 - C. Yes usually
 - D. No never
20. If yes how do you invest this surplus amount of cash?
- A. Deposit in the bank for interest
 - B. Expand the business
 - C. Buy money market instrument
 - D. If other please specify
21. Are all cash payment transactions being checked and approved by the right person before effected?
- A. Yes
 - B. No
22. If you answer yes for the above question, how do you rate the approval process?
- A. Very strong
 - B. Moderately strong
 - C. Strong
 - D. Weak
 - E. Very weak

23. Are all cash payment transactions promptly recorded?

- A. Yes
- B. No

24. How does your company effect cash payment?

- A. By check
- B. By cash
- C. If other please specify _____

Part Four: Questions Related With Receivable Management Practices

25. Did you sell on Credit?

- A. Yes
- B. No

26. If you answer yes for the above question, do you establish credit limits for each customer?

- A. Yes
- B. No

27. If you answer yes for the above question, what is the maximum credit limit for a customer? _____

28. How often do you review your level of receivables and irrecoverable debts?

- A. Once in a month
- B. Half a year
- C. Yearly
- D. If other please specify _____

29. How do you rate the adequacy of receivables collection effort of your company?

- A. Very adequate
- B. Less adequate
- C. Somehow adequate
- D. Very less adequate
- E. Not adequate

Part five questions related with inventory management practices

30. Do you prepare inventory budgets?

- A. Yes
- B. No

31. If yes how do you determine the level of inventory in preparing inventory budget?

- A. using methods of inventory management
- B. Through owner and manager experience

Part six: questions related with account payable management practices

32. Did you purchase on credit?

A. Yes

B. No

33. Do you have any access that you can get a loan from credit association?

A. Yes

B. NO

34. If your answer is yes on question 34 above what is the maximum credit limit for you?

APPENDIX: B INTERVIEW

1. Do you prepare financial statement?
2. How do you pay tax?