

# Effect of Working Capital Management Practices on the Performance of Listed Nigerian Pharmaceutical Companies.

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## ABSTRACT

This study investigated the effect of working capital management practices on the performance of listed Nigerian pharmaceutical companies. Specifically, it examined the effect of working capital management components on Cash Flow Return on Investment. . Secondary data were extracted from audited annual reports and accounts of five selected pharmaceutical companies listed on the Nigerian Exchange Group (NGX) using judgmental sampling technique. Panel data regression was used to analyze the data collected over ten years period (2009-2019). Results of Panel Regression revealed that RTD ( $\beta=-1.44583, t=-2.69, p=0.007$ ) and DR ( $\beta =-0.1275989, t=-3.40, p=0.001$ ) have negative and significance effects on CFROI which implies that 1% increase in Receivable Turnovers in Days decreases Cash flow Returns on Investment by 1.44% and 1% increase in Debt Ratio decreases Cash flow Returns on Investment by 0.127%. The study therefore concluded that a significant and negative relationship existed between RTD, DR and Cash flow Returns on Investment of listed pharmaceutical companies in Nigeria. This study, therefore, recommended that Managers of pharmaceutical companies should maintain optimal level of stocks, decreases number of days receivables and depends on internal sources of fund than external sources in order to maximize cash flow returns on investment of pharmaceutical companies.

**Key word:** working capital components, cash flow returns on investment.

## 1.0 INTRODUCTION

The management of working capital is one of the most challenging issues for financial managers, as the success or otherwise of the management of the financial ratio affects the company either positively or negatively (Baveld, 2012; Ojeani, 2014; Eya, 2016; Olufemi and Olufemi, 2020). According to (Kesimli and Gunary, (2011), Working capital management refers to a company's managerial accounting strategy designed to monitor and utilize the two components of working capital, current assets and current liabilities, to ensure the most financially efficient operation of the company's. In other words, efficient working capital management means ensuring sufficient liquidity in the business to be able to satisfy short term expenses and debt. It includes working capital financing and managing the current assets and current liabilities. With an efficient management of working capital, company could lower their dependence on external investment and for enhancing the company's financial flexibility (Eya, 2016).

Working capital management plays vital role in the success of any business enterprises. It is an effective management technique tool that has the potential of guaranteeing long-term success. Among others, it helps a business unit in ensuring that tied down capital is otherwise put to productive uses and assists company s to maintain good relation with suppliers and other creditor as well as to avoid overtrading and underutilization of resources which could otherwise provides better insight into the true financial state of the company. Therefore, financial managers should go extra mile in striving for optimum utilization of

resources tied to working capital so as to stimulate the expansion of investment portfolio, and to ensure the availability of sufficient resources, in order to solidify the going concern status of the company, as well as increase profitability.

Pharmaceutical companies in today's world are normally comprised of machines, robots, computers and human that work in a specific manner to create a product (www.investopedia 2020). Pharmaceutical companies constitute key sector in both Nigerian and global economy as well as drive medical progress by researching, developing and bringing new medicines that improve health and quality of life for patients around the world (Ojeani, 2014). According to the Nigerian Bureau of Statistics, the contribution of pharmaceutical companies to the nation's Gross Domestic Products (GDP) from 2016 to 2019 are 1.19%, 0.79%, 0.61% and 0.35% respectively. Despite the high demand of pharmaceutical business in Nigeria, the market is described as one of the smallest among middle and East African (MEA) region, and with the exception of few globally recognized brands, many of the pharmaceutical companies in Nigeria cannot adequately compete internationally (Ojeani, 2014). Previous study on the performance of Nigerian pharmaceutical companies have identify low return on investment (Sylvester 2020 and Mariana et al 2016).. Deloof (2003) observed that investing significant quantity of cash in accounts receivable as a source of financing in nearly all the pharmaceutical companies' causes a great problem on the performance of the company especially as going concern. Extending payables for as long as possible to maximize the free cash flow approach by many companies can erode supplier moral and goodwill which can result to slower deliveries of goods and services, less willingness to fix issues, delayed responses to important queries whereas early payment yield substantial benefits like early payment discounts and rebates.

These issues are attributed to inefficient and ineffective management of working capital by the financial managers, a situation that has reinforce decline in the financial performance of pharmaceutical companies in Nigeria. Therefore, the effect of working capital management practices on the financial performance of pharmaceutical companies in Nigeria requires adequate research and thus constituting the main focus of this current study.

### **Research Question**

1. To what extent does working capital management component influence the Cash flow Return on Investment (CRROI) of listed Pharmaceutical companies in Nigeria?
2. What are the effects of Debt Ratio (DR) on Cash flow Return on Investment of listed Pharmaceutical companies in Nigeria?

### **Research Objectives**

Examine the effect of Receivable Turnover in Days (RTD) on Cash flow Return on Investment (CFROI) of listed Pharmaceutical Companies in Nigeria.

Measure the effects of Debt Ratio (DR) on Cash flow Return on Investment of listed Pharmaceutical companies in Nigeria

### **Research Hypotheses**

The hypotheses developed for this study were stated in null form.

There is no significant relationship between Working Capital Management components and Cash Flow Return on Investment (CFROI) of listed pharmaceutical companies in Nigeria.

There is no significant relationship between Debt Ratio (DR) and Cash Flow Return on Investment (CFROI) of listed pharmaceutical companies in Nigeria.

## **2.0 LITERATURE REVIEW**

### **Working Capital Management**

Working capital management is defined as the management of investment in current assets and the financing of the current assets, and involves setting working capital management policy and carrying out that policy in a business's daily operations, to achieve its goals and objectives, such as shareholders wealth maximization, competitive advantage and growth (Oladimeji, & Olufemi. 2017).

### **Working Capital Management Practices**

Working capital management practices entails coordinating several tasks such as managing short term investments, granting credit to customers, and collecting on the credit, managing investment, and managing payables. It connotes the management of man, materials, machines, time and money, in order to achieve the greatest organizational value. This comprises of inventory, payable, receivables, and cash conversion cycle management which can be categorized as resources and liquidity management (Maverick, 2021).

### **Liquidity Management**

Liquidity management is one of the crucial goals of working capital management and central pillar of cash management. The main objectives of liquidity management are to determine the amount of cash available to meet the company's obligation and for routine payments so as to keep the business afloat (Alhassan & Anwaul, 2021).

### **Resources Management**

According to Anuradadha & Sudeshina, (2021), Resources management refers to the practice and planning, scheduling and allocating people, money and technology in order to ensure optimization and appropriate allocation of resources. Such resources may include the financial resources, inventory, human skills, production resources, or information technology and natural resources.

### **Inventory Management**

Inventory represents a large part of the total assets of many companies, and an effective management is needed for normal production and selling operations of the company and for keeping costs of holding inventory at a minimum. The goal of inventory management is to minimize the costs of storing and financing goods while maintaining a level of inventories that satisfies the amounts of sales of company (Baveld, 2012). According to Deloof (2003), with inventory management, there is a tradeoff between sales and costs. A company needs to determine an optimal level of stocks

### **Account Receivables Management**

These can be seen as short-term loans to customers given by the supplying company. Giving these credit terms to customers are an important way of securing sales. Although the total amount of receivables on a balance sheet of a company could be constant overtime, its components are continually shifting, and therefore careful monitoring is needed. When the account receivable keeps growing, funds are unavailable and therefore can be seen as opportunity costs (Baveld, 2012).

### **Account Payables Management**

These are the opposite of account payable, instead of giving a credit on a sale, a company receives a credit. When a company makes a purchase on credit, it incurs an obligation to pay for the goods according to the term given by the seller. Until the cash is paid for the goods, the obligation to pay is recorded in account

payables. Account payables can be seen as a short term loan, or in other words, a source of funding. Apart from serve as a source of funding, account payables using the trade credit terms of a supplier can also be used to asses product quality. This assessment has to be done during the credit term, and if the quality of the product is not satisfying, it can be sent back without paying the bill.

### Measurement of Financial Performance

Performance measurement is one of the essential topics which have been much debated today because it serve as the bases on which the company s are trying to maximize the interests of the shareholders as well as the indexes which are taken into consideration by the financial institutions to grant facilities to the company s performance .Evaluation is a necessity, and accepted measures should be applied to consider the different aspects in terms of the limitations in the operations and utilization of the facilities (Mehdi *et al.*, 2013). Organizational strategies resources and the performance evaluation system should be well focus by the managers in other to maximize the intrinsic value for the shareholders during the consecutive periods which is the ultimate goal of the any company s. Only when value creation exceeds the risk – the adjusted costs of capital is added value created (Tomas &Rima., 2010).

The concept of shareholder value has been one of the driving forces in the change of current management practice. The value approach implied a change in the Management process and the managers began to direct their focus on creating shareholder value. Thus, traditional accounting numbers such as return on investment, earnings per share and operating profit have been augmented by ‘new’ measures and ratios. Cash flow return on investment is useful for both managers and a security analyst of company which shows the residual cash flow with generates investment to company and reflect the time-adjusted rate that will produce a net present value of zero. This study will examine the measure by the way it incorporate the idea of shareholder value, their flexibility in application to the valuation of companies and the measurement of financial performance.

### Cash Flow Return on Investment (CFROI):

Cash flow return on investment focuses on the return offer to all the capital providers of the company and not only the shareholders thereby serve as a solution to agency problems (Madden, 1999). It is a modified version of internal rate of return, designed for investment that have already been made and it expresses an estimates of a company single period cash flow as a percentage of total investment (Herbert, 2012). Dzamba (2003) opined that cash flow return on investment represents the future risk exposure of the company, since it is a risk- adjusted discount rate.

CFROI = Cash Value Added/ Gross investment +Weighted average cost of capital.

### The Debt Ratio (DR)

The Debt Ratio (Leverage) measure the financial risk and the company ’s ability of using debt to shareholder’s advantage, and it was used as a control variable by many authors like Anastiasia (2014), Almausheki *et al.* (2019) and Charitou *et al.* (2010), Employment of debt is advantages for shareholders in two ways: (i) they can retain control of the company with a limited stake and (ii) their earning will be magnified, when the company earns a rate of return on the total capital employed higher than the interest rate on the borrowed funds. Financial leverage is the process of magnifying the shareholder return through the employment of debt. However, leverage can work in the opposite direction as well. If the cost of debt is higher that the company’s overall rate of return, the earrings of shareholders will be reduced, which may become a threat of insolvency? This ratio is calculated as

$$\text{Debt Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

## Empirical Review

Siraj *et al.* (2019) examined the effect of working capital management on the performance of non-financial companies in Pakistan by taking a sample of panel data of 280 non-financial companies enlisted in Pakistan Stock Exchange over the period of sixteen years (2000-2016). The study used return on assets and return on equity as the output's variables while inventory management, receivable management and payable management serves as the input variable and company size liquidity and leverage as the control variables. The hypotheses were tested using the multiple regression analysis with fixed effect model. The study suggested that working capital management has a significant impact on companies' financial performance in terms of profitability as well as growth.

Yahaya (2018) examined the effect of working capital management on profitability of quoted bottling companies in Nigeria for the period of 2001 to 2014. The study used census approach and specifically seeks to assess the impact of inventory turnover days, account receivable days, account payable days and cash conversion cycle on profitability of the bottling companies. The study adopted correlation Research design and data were analyzed with the aid of OLS multiple regression technique. Using 98 company year observations, the study found that inventory turnover days have positive and strong impact on profitability of quoted bottling companies in Nigeria at 1% level of significance. Also, account receivable days have a negative and significant effect on profitability of the quoted bottling companies at 5% levels of significance. However, account payable days found to have positive but insignificant influence on profitability of the companies, which the cash conversion cycle has a positive and significant influence on the profitability of the quoted companies. The study finds that, increase in the cash conversion cycle will generate more profits, while increase in inventory turnover days and decrease in account receivable days will generate more profits. The study concluded that, efficient management of working capital affects the performance of quoted bottling companies in Nigeria.

Oseifuah *et al.* (2017) investigated the impact of working capital management and shareholder's wealth creation of non-financial companies listed on the Johannesburg stock Exchange. Panel data regression analysis was used to analyze accounting data obtained from 1-Net Bridge/BFA Mc Gregor of 75 companies for the period of 10 years (2003 – 2012), to determine the relationship between working capital management and profitability. The study used the company value (market capitalization) as the output variables and Cash Conversion Cycle (CCC), Inventory Conversion Period (ICP), Receivables Conversion Period (RCP) and Payables Deferral Period (PDP) as the input variables. The results of the study show there exist a significant positive relationship between company value and both inventory conversion period and receivable conversion period. Moreover, it stressed that the relationship between cash conversion cycle and company value is positive but relationship between accounts payable deferral period and profitability is negative.

Tomas and Rima (2008) investigated corporate performance and the measures of value added of JSC Kauno tiekimas in Lithuanian USA for the period of 2003 to 2005. The study concluded that efficient management of working capital has positive impact on MVA, EVA, CVA and CFROI of manufacturing companies.

## METHODOLOGY

### Research Design

This study examined working capital management practices and its effect on the financial performance of listed pharmaceutical companies in Nigeria. Ex-post factor research designs were adopted in which investigation starts on several variables after the facts have occurred. In order to establish causal relationship or otherwise among the variables, correlation analysis were designed to determine the degree of association between variables, and to estimate the effect of independent variables on the dependent variables. Other relevant data were analyzed using panel data analysis.

## Study Population

The population of the study comprises all eleven (11) pharmaceutical companies listed on the Nigerian Exchange Group (NGX) as at December 2019.

## Sample Size and sampling Technique

Due to constraint in time and resources as well as limited number of pharmaceutical companies in Nigeria, a non-probability sampling technique (judgmental sampling) was used for the study. Five pharmaceutical companies were selected on the basis of audited annual report availability. The companies are May and Baker Nigeria Plc, GlaxoSmithline (GSK), Neimeth International Pharmaceutical Plc, Fidson Health Care Plc and Pharma-Deko Plc.

## Method of Data Collection

The studies used secondary data extracted which were extracted from audited annual report and accounts of the selected companies from 2009-2019.

## Method of Data Analysis

The data were analyzed using inferential statistics such as correlation models to measure the degree of association between the value added and working capital management respectively. Also, Hussmann test was conducted to check for the presence of auto correlation in the data.

## Model Specifications

To examine the effect of working capital management components on the cash flow return on investment of listed pharmaceutical companies in Nigeria. Cash Flow Return on Investment (CROI) is dependent variable while Inventory Turnover in Days (ITD), Receivable Turnovers in Days (RTD), Payable Turnover in Days (PTD) and Cash Conversion Cycle (CCC) are the independent variables. Sales Growth (SG), Debt Ratio (DR), and Company Size (SIZE) are the control variables while Sales per Employees Ratio (SER) serves as mediating variables

$$CFROI = f(CCC, \epsilon_{it}) \quad \text{--(3.1)}$$

$$CFROI = f(ITD, RTD, PTD, \epsilon_{it}) \quad \text{--(3.2)}$$

$$CFROI = \alpha + \beta_1ITD_{it} + \beta_2RTD_{it} + \beta_3PTD_{it} + \beta_4CCC_{it} + \beta_5SG_{it} + \beta_6DR_{it} + \beta_7SIZE_{it} + \beta_8SER_{it} + \epsilon_{it} \quad (3.3)$$

**Table 3.2 Coefficients in the Models**

CFROI =	Cash Flow Return on Investment (A proxy of company performance).
RTD	Receivable Turnover in Days
PTD	Payable Turnover in Days
ITD	Inventory Turnover in Days.
SG	Sales Growth.

DR	Debt Ratio.
SIZE	Total Size of Assets
SER	Sales per Employees Ratio
E	Error Term
$\alpha$	Constant
B	coefficient of independent variables
In	natural logarithm

## RESULTS AND DISCUSSIONS

This section of the study provides empirical analysis of effect of working capital management practices on the performance of listed Nigerian pharmaceutical companies over a period of ten years (2010-2019). Data for this study were obtained through secondary sources from the audited annual reports and accounts of the sampled firms within the year 2009-2019. A detailed analysis of the generated data on each objective is contained in the following sections.

### Hausman Test Result conducted on Effect of Working Capital Management Practices on Profitability of Listed Pharmaceutical Companies in Nigeria.

The use of Hausmann test becomes imperative to compare and choose between fixed and random effect models. The null hypothesis is that if Hausmann p-value is  $>0.05$ , random effect model is preferable, while if Hausmann p-value is  $<0.05$ , fixed effect model is preferable. Random effect model is chosen for objective one, two and three as  $\text{Prob}>\chi^2>0.05$  ( $\text{Prob}>\chi^2=0.6062, 0.8210$  and  $0.5240$ ) as shown in the table below.

	--- Coefficients ---			
	(b)	(B)	(b-B)	$\sqrt{\text{diag}(V_b - V_B)}$
	fe	re	Difference	S.E.
logitd2	1.436706	-1.004465	2.441171	3.266552
logrtd2	-1.186811	-1.44583	0.2590191	0.323039
logptd2	1.280926	1.896926	-0.6159996	0.607056
logccc2	1.915315	1.607057	.3082579	0.57908
logser3	-3.26308	-0.1754061	-3.087674	5.192864
logsg	-.0833182	.081772	-0.1650902	0.12517
dr	-0.1293247	-0.1275989	-0.0017258	.0131356

b = consistent under Ho and Ha; obtained from xtreg	B = inconsistent under Ha, efficient under Ho; obtained from xtreg			
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Test: Ho: difference in coefficients not systematic

$$\chi^2(7) = (b-B)'[(V_b-V_B)^{-1}](b-B)$$

$$= 5.44$$

$$\text{Prob} > \chi^2 = 0.6062$$

( $V_b - V_B$  is not positive definite)

#### 4.5 Random Effect Model Result on Effect of Working Capital Components on Cash Flow Return on Investment of Listed Pharmaceutical Companies in Nigeria.

The result in Table 4.5 showed the effect of ITD, RTD, PTD, CCC, SER, SG, and DR on Cash Flow Return on Investment (CFROI). From the Table 4.5, it was shown that Receivables Turnover Days (RTD) has negative and significant relationship with Cash Flow Return on Investment (CFROI) ( $\beta = -1.44583$ ,  $P = 0.007$ ). This implies that a unit increase in RTD decreases CFROI by -1.45%. This further connotes that the lower the receivables turnover days, the higher the cash flow return. Also, the study found inverse relationship between DR and CFROI ( $\beta = -.1275989$ ,  $P = 0.001$ ). 1% increase in debt decrease cash flow by 0.13. The adjusted  $R^2$  of 0.3960 revealed that the independent variables were responsible for 40% of variation in the dependent variables (CFROI). The Wald  $\chi^2$  (7) of 16.32 and  $\text{Prob} > \chi^2$  of 0.0223 showed the goodness of fit of the variables used in the model and concluded that they were significant at 5% level of significance.

**Table 4.5.1 Random Effect Result Effect of Working Capital Components on Cash Flow Return on Investment of Listed Pharmaceutical Companies in Nigeria.**

Dependent variables	Independent variables	Coefficient	Standard error	t	P>/t/	(95% conf. Interval)	
LOG CFROI	LOG ITD	-1.004465	2.388464	-0.42	0.674	-5.685768	3.676839
	LOG RTD	-1.44583	.5373125	-2.69	0.007	-2.498943	-.3927168
	LOG PTD	1.896926	1.610618	1.18	0.239	-1.259828	5.05368
	LOG CCC	1.607057	1.200092	1.34	0.181	-.7450793	3.959193
	LOG SER	-.1754061	2.139135	-0.08	0.935	-4.368033	4.017221
	LOG SG	.081772	.0683383	1.20	0.231	-.0521685	.2157125
	LOG DR	-.1275989	.0375267	-3.40	0.001	-.2011499	-.0540479
	CONSTANT	-3.108782	6.35683	-0.49	0.625	-15.56794	9.350375
<b>R squared =0.3960</b>		<b>Wald chi2=16.32</b>			<b>Prob&gt;chi2= 0.0223</b>		

Source: Researcher's Computation 2021.



## 5.1 Summary of the study

This study examined the effect of working capital management practices on the financial performance of listed Nigerian pharmaceutical companies. The specific objectives were to examine the effect of working capital components on the cash flow return on investment, This study has employed judgmental sampling technique due to constraints in resources and time. The sample size consists of five pharmaceutical companies selected on the basis of audited annual report availability. Secondary data was used for the study which was obtained from published annual reports and accounts of the sampled firms for ten years period from 2010 to 2019. The results of the panel unit root test conducted showed that all the variables are stationary (no unit root) at the levels except sales per employees ratio which was stationary at first difference i.e. integrated of order one 1 (1). The study made use of inferential statistics where panel data (fixed effect, random effect and pooled OLS) was used to analyze the data.

In case of hypothesis one, there is no relationship between working capital components and cash flow return on investment; data gathered was analyzed using panel data analysis (random effect model) with the result showing the co-efficient of determination ( $R^2$ ) 0.2799. This means that the independent variables in the model could only explain 28% percent of total variation in cash flow return on investment with respect to the selected companies leaving the remaining part of variation to exogenous variable not used in the model. This showed that the variables explain a small portion of the variation which signifies a weaker variable were used or that some important variable to this study were not discussed in the study. Hence, null hypothesis is rejected while the alternative hypothesis is accepted that there is significant relationship between working capital components and cash flow return on investment of listed pharmaceutical companies.

## CONCLUSION

Based on the outcome of data analyses on the effects of working capital management practices on the performance of listed pharmaceutical companies in Nigeria, the study concluded that working capital component (receivable turnover days (RTD) had negative and significant effect on Cash Flow Return on Investment while Debt Ratio also had negative and significant effect on Cash Flow Return on Investment of listed pharmaceutical companies in Nigeria

## 5.3 RECOMMENDATIONS

Based on findings from, the study recommended that managers of pharmaceutical companies should maintain optimal level of stocks, decreases number of days receivables and depends on internal sources of fund than external sources in other to maximize cash flow returns on investment of pharmaceutical companies.

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