

EXTENDED ABSTRACT

IMPACT OF CASH CONVERSION CYCLE ON PROFITABILITY OF SMALL AND MEDIUM ENTERPRISES IN BATTICALOA DISTRICT

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(Published 15 October 2021)

Abstract

The study aims to examine the impact of the cash conversion cycle on the profitability of SMEs in Batticaloa district. A sample of 100 SMEs was selected from Batticaloa District based on stratified random sampling method. Descriptive statistics was used to represent the responses from the respondents of SMEs and regression analysis was also used in this study in order to examine the impact of cash conversion cycle and inventory holding period on the profitability of SMEs. The results depicted that there is a significant impact of cash conversion cycle and inventory holding period on the profitability of the SMEs in Batticaloa. These results emphasize the importance of the cash conversion cycle to the function of SMEs. In order to manage the cash conversion cycle, it is recommended to SMEs have various initiatives as it is evident that SMEs are one of the key contributors to developing economies.

Keywords: Cash conversion cycle, enterprises, Batticaloa

1. Introduction

Small and medium enterprises are considered to be the vital sector in the economy of the country as 90% of the establishments fall under the category of SMEs. Batticaloa district's economy mainly depends on agriculture and the SMEs. However, the performance of the SME sector in the Batticaloa district is not very effective due to many reasons (Department of Census and Statistics, 2020). They are difficulty in accessing the finance, customer satisfaction, and globalization, scarcity of raw material, skilled human resources and changes in technology during the initial stage of the SMEs. Yet, the main reason for the incompetence of SME's is the lack of working capital management practices which is thoroughly uninformed among the SMEs owners overall Sri Lanka and in Batticaloa District as well (Department of Census and Statistics, 2020).

Farrah, Noredi & Othman (2016) from their study showed that less efficiency could be seen in the selected small and medium enterprises regarding the managing of their working capital. And they emphasized that ineffective utilization of assets and decreases in short term investment are the results of improper management of working capital. Therefore, inefficient working capital management could lead to the failure of SMEs.

Efficiency of the working capital management could be measured by various proxies. Among those proxies, cash conversion cycle is considered to be an important proxy (Vural et al, 2012). Moreover, Jamil et al. (2015) mentioned that accounts payable turnover days, accounts receivables

turnover days, and inventory turnover days, fixed financial assets ratio, debt ratio and size are various other proxies for measuring the working capital management.

There are various researches that have addressed the issue of poor working capital management practices and performance of SMEs by considering factors such as, poor knowledge among the owners of SMEs on accounting and working capital management, etc. However, it can be seen that previous literature/researches have not studied the impact of cash conversion cycle on profitability of SMEs. Thus, this study will aim at finding the impact of cash conversion cycle on profitability of SMEs in Batticaloa district.

2. Methodology

Population consisted of registered small and medium enterprises from KorlaiPatru West Divisional Secretariat of the Batticaloa district. Among 14 Divisional Secretariat in Batticaloa District, KorlaiPatru West Division was selected for the study as it has highest number of registered SMEs (Department of Census and Statistics, 2020). The total population of this division is 442 numbers of registered small and medium enterprises. A sample of 100 from the population of SMEs was selected based on stratified random sampling. The sample was divided into homogeneous sub groups based on the types of SMEs. For the gathering of primary data, structured 5-point Likert-scale of questionnaires was issued. Three proxies have been to measure the cash conversion cycle. They are Inventory Holding Period (IHP), Account Receivable Period (ARP) and Accounts Payable Period (APP). Descriptive and inferential statistics were used in this study. Multiple regression models were used to examine the impact of working capital management practices on SMEs profitability.

3. Reliability Analysis

The strength of the consistency was measured using Cronbach's alpha. According to Hulin, Nete-meyer, & Cudeck, (2001), if the Coefficients indicates values of 0.6 - 0.7 then there is an acceptable level of reliability, and if it is 0.8 or greater, the internal consistency is considered to be very good level. According to the results, the 0.969 was the overall Cronbach's alpha coefficient with regard to 14 statements. Therefore, it is considered that all the items considered in this study are reliable, which emphasize satisfactory of the internal reliability of the instruments.

4. Results and Discussion

The respondents were asked to rate statements on a scale of 1 to 5 where 1- Strongly Disagree, 2- Disagree, 3- Not sure, 4- Agree, 5- Strongly Agree. Table 1 represents the results.

Table 1. Cash conversion Cycle and Profitability

Statement	1	2	3	4	5	Mean	SD
The duration of CCC has a substantial influence on the profitability	0%	4.3%	4.5%	35.6%	55.6%	4.32	0.84
Shorter cash conversion cycles are better than longer ones	0%	4.3%	8.6%	37.3%	49.8%	4.92	0.87
Each SME ought to fix its standard level of CCC	1.3%	3.2%	4.9%	58.1%	32.5%	4.56	0.79
Lower-level staff are responsible for management of CCC	60.1%	18.2%	6.4%	15.2%	0.1%	3.21	0.89
Average						4.25	0.85

According to the results, majority of the respondents with the percentage of 55.6% strongly agreed that the profitability of the SMEs are affected by the duration of cash conversion cycle. And

it was further agreed by the 35.6% of the respondents. Along with that, 49.8% of the respondents strongly agreed that shorter cash conversion cycles are better than longer CCC. This was again supported by the 37.3% respondents who were agreed for the statement. 58.1% of the respondents agree that each SME ought to fix its standard level of CCC even though only 32.5% respondents strongly agreed for the standard level of CCC. 60.1% respondents strongly disagreed that lower-level staff are responsible for management of cash conversion cycle. A regression analysis was done to examine the impact of cash conversion cycle on the profitability of SMEs. According to the regression analysis, it showed that there is a significant impact of cash conversion cycle on the profitability of the SMEs. ($B=0.199$ and $P=0.013$ which is less than 0.05).

Table 2. Effect of the Inventory Holding Period on the Profitability of SME

Statement	1	2	3	4	5	Mean	SD
The duration of IHP has a significant influence on the profitability of SMEs	0.0%	5.1%	2.2%	34.5%	58.2%	4.34	0.89
In order to maintain adequate stocks, there is need for the firms to set EOQ	0.0%	0.0%	4.5%	50.6%	44.9%	4.21	0.79
Profitability is negatively affected by extended IHP	3.1%	5.2%	2.3%	42.5%	46.9%	3.78	0.85
Poor inventory management will affect the long-term profitability and firm's survival chances	2.0%	4.5%	8.1%	38.1%	47.3%	4.01	0.79
Average						4.08	0.83

Based on the above results 58.2% of the respondents strongly agreed and 34.5% of the respondents agreed that there is a significant influence of inventory holding period on the profitability of SMEs. At the same time, 50.6% of the respondents agreed that the firms need to set the EOQ in order to maintain adequate stocks in the firms. The importance of EOQ in the maintenance of adequate stocks were strongly agreed by 44.9% of the respondents. 46.9% of the respondents strongly agreed that extension of the inventory holding period, could affect their profitability negatively. Nearly half of the respondents (47.3%) strongly accepted that firm's survival and long-term profitability will be affected due to the poor inventory management. Based on the regression analysis, it can be seen that inventory holding period has impact on the profitability of SMEs ($B=.284$, $P=0.00$ which is less than 0.05).

5. Conclusion

The study was conducted to examine the impact of cash conversion cycle on the profitability of SMEs in Batticaloa district. Along with that impact of inventory holding period on profitability of SMEs also examined using the regression analysis. It showed that there is a significant impact of cash conversion cycle and inventory holding period on the profitability of the SMEs in Batticaloa. This result concludes that the cash conversion cycle is important to the operation of the firms. Most of the respondents strongly agreed that there is an impact of cash conversion cycle on the profitability of SMEs. In order to manage the cash conversion cycle, it is recommended to the SMEs to manage their cash conversion cycle by reviewing their past cash flows and breakdown in to monthly period, manage to get the receivable as early as possible and payables later. Finally, SMEs need to have good relationship with their customers and suppliers in managing their cash conversion cycle. At the same time, SMEs also need to consider their inventory management as it was evident that inventory holding period impact on the profitability of the SMEs. Therefore, it is recommended to the SMEs to have proper inventory management practices.

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