

Journal of Economics and Business

Bernard, D. T. K, Almeida, A, Perera, S, Senevirathna, M, Jayarathna, H, and Munasighe, A. A. S. N. (2019), The Effect of Working Capital Management on the Export Performance of Small and Medium Export Enterprises: Evidence from Export Manufacturing Sector in Sri Lanka. In: *Journal of Economics and Business*, Vol.2, No.3, 660-675.

ISSN 2615-3726

DOI: 10.31014/aior.1992.02.03.117

The online version of this article can be found at:
<https://www.asianinstituteofresearch.org/>

Published by:
The Asian Institute of Research

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The Effect of Working Capital Management on the Export Performance of Small and Medium Export Enterprises: Evidence from Export Manufacturing Sector in Sri Lanka

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Abstract

Small and Medium Enterprises (SMEs) are critical for the development of the economy in any country and known as the backbone of industrial development in both developing and developed countries. SMEs play a key role in the economy in terms of their contribution to the national output, employment, and the number of firms operating in the country. Effective management of working capital management is necessary for a firm's survival as well as the success of a business. It is essential to maintain a healthy working capital of Small and Medium Scale Enterprises to keep the solvency and liquidity of SMEs. The problem identified in the research was that, in Sri Lanka, 82% of SMEs are export enterprises which are expected to provide a substantial contribution to the total exports of the country, however, at present, it only contributes approximately 5% of total exports. Therefore, the main objective of the study, was to identify whether there is an effect of working capital management (WCM) practices towards the export performance of the SMEs. The respondents were chosen through a systematic sampling technique, and the responses were analyzed using SPSS version 21 to discover impact of WCM on export performance of the company. The results of the study showed that Receivable management, Inventory management, and Payable management significantly affect export performance while cash management does not have a significant effect. Findings concluded that there is a positive relationship between WCM practices and export performance of SMEs. Hence, in order to enhance the export performance, SMEs should also consider their working capital practices among other requirements.

Keywords: SMEs, WCM, Export Performance, Manufacturing Sector

I. INTRODUCTION

Small and Medium Enterprises are important for the growth of the economy in every country and known as the backbone of industrial development in both developing and developed countries. In Sri Lanka, SMEs have gained a wide recognition as a major source of employment, income generation, poverty alleviation, and regional development. SMEs play a major role in the economies in terms of their contribution to national output, employment, and number of operating in countries. In the Sri Lankan context, Small and Medium Enterprises cover a wide range of sectors such as agriculture, manufacturing, construction, and service sector industries. However, reliable data are available only for the manufacturing sector. Within the manufacturing sector, SMEs

account for about 96% of industrial units 36% of employment and 20% of value addition (Task Force for SME sector program, 2002). Hence, the manufacturing sector has been selected to be the study area of the research.

The role of Small and Medium Scale Enterprises (SMEs) in the world economy has been highly emphasized as the means through which rapid industrialization and other development goals of a nation can be realized. Despite their significance and the increased efforts by governments and other stakeholders to ensure the success of small-scale enterprises, they continue to exhibit high birth rates and high death rates (Hamza, Mutala & Antwi, 2015).

Even though successive governments have taken various steps to develop SMEs since independence in Sri Lanka, the contribution of SMEs to the national economy in Sri Lanka is comparatively low when compared with developed and developing countries in the region (Rathnasiri, 2015).

In both developing and developed countries, exports play a major role in the development of the economy of the country, influencing the economic growth, the balance of payment and employment. Looking at the contribution of SMEs for Sri Lankan exports, in spite of the increased strategic significance of internationalization initiatives for the SMEs, there is still an insufficient level of commitment to adopting global practices among SMEs. In this regard, only 3157 SMEs are registered under the Export Development Board (EDB) as exporters out of more than a million number of establishments.

Furthermore, SME contribution to total exports is around 5% although SMEs account for 82% of registered exporters of the country. Even in Sri Lanka, 82% of SMEs consist of export enterprises and expected to provide a higher contribution to the total exports of the country, but provides only around 5% contribution (Mudalige, 2017). There are many reasons for the downfall or poor growth in exports in many countries. According to past research studies; working capital practices, the financial position of the firm, marketing knowledge and information, technological issues, marketing activities, quality problems, language barriers are a few of the reasons identified (Siringoringo, Tintri & Kowanda, 2009). However, out of all these reasons researchers have highlighted working capital as the main reason for the downfall of exports in many countries.

There are similar research conducted in this research area about of SMEs. Therefore, this study focus on working capital management practices and the export performance. This research spread to cash management practices, inventory management practices, receivable management practices and payable management practices as working capital management practices.

The main objective of the study was to identify whether there is an effect of working capital management practices towards the export performance of the SMEs.

II. LITERATURE REVIEW

Definition of SMEs

Definitions for SMEs differ from country to country based on their level of development. The commonly used yardsticks are; total number of employees, annual turnover, and total investment.

In the Sri Lankan context, the SME policy framework defines SMEs based on the number of employees and annual turnover. The category of Small and Medium-sized Enterprises (SMEs) is made up of enterprises which employ less than 300 employees and which have an annual turnover not exceeding Rs.750 Million. In this context, micro enterprises are also read with SMEs for any policy-related measures (Commerce, 2015).

In Sri Lanka, SMEs account for a major proportion from the total number of industries and business establishments, which is the case with regard to many developing countries. SMEs promote economic growth by import substitution as well as through direct exports, and they mainly supply goods and services to large directly exporting ventures and thereby contribute towards alleviating balance of payment difficulties (Hewaliyanage, 2001).

SMEs account for 80% - 90% of the total number of enterprises in Sri Lanka and contribute 30% in terms of value added and account for 32.7% of the employment from agriculture sector, 26.3% of the employment from Industrial sector, 41% of the employment from Services sector (Task Force for SME sector program, 2002). It proves that SMEs in Sri Lanka contributes to enhance the employment level, per capita income level and reduce the poverty level while developing regional areas of the country. Even though SMEs in Sri Lanka contribute highly to the GDP, their contribution to the total exports is around 5%.

Manufacturing sector

Manufacturing is a wealth-producing or wealth creating sector in the economy, where the service sector tends to be wealth consuming (Friedman, 2006). Most of the third world economies process strong manufacturing base while providing employment opportunities. According to the 2010 United Nations (UN) data, the US is still the largest manufacturer in the world, with a share of 20.2% of the world's manufacturing, closely followed by China at 18.9%. Japan is third with 11.1% of manufacturing and Germany fourth with 6.4%. The top 10 countries in the world contribute 72.3% of the world's manufacturing (Jkwala, 2012).

$\text{Net Working Capital (NWC)} = \text{Current Assets (CA)} - \text{Current Liabilities (CL)} \dots\dots\dots (1)$

Working capital management

Working Capital Management enables firms to finance the difference between short-term assets and liabilities (Harris, 2005). Working Capital consists of managing working capital components; including cash management, inventory, receivables as current assets and bank overdraft and short-term loans as Current Liabilities. Working capital might have a significant impact over financial performance and risk of failure of business,

Working capital management is an attempt to handle the current assets, the current liabilities and the interrelationship that occurs between them. Arnold (2008) mentioned that net working capital or working capital is the difference between current assets and current liabilities. Working capital is outlined in an algebraic expression as follows:

Components of working capital management

Cash management

Cash management determines the level of cash required to run the day to day functions of the firm without a failure. As mentioned by McLaney (2000) cash is not just an element of working capital but it stores value and acts as a medium of exchange providing a linkage between all monetary aspects of the firm.

Inventory management

The main aim of inventory management is to hold a minimum level of stocks concerning the cost. According to the study of working capital management of SMEs which is done by Pell & Wilson (1996), it is emphasized that when managing the working capital in an SME their main focus has to go towards reviewing of stock turnover, stock levels, stock re-order levels and the usage of economic order quantity model. By considering these factors, firms could be able to determine the inventory levels, frequency, and reasonableness of inventory levels and inventory budgets preparation.

Receivable management

Accounts receivables are a mode of attracting customers to increase sales of a business. This is because it allows a customer to consume or use the product without making payment and then to pay the due amount after a specific period (Bagchi & Khamrui, 2012). It is important to manage receivables of a firm as the success of a firm depends on the management of receivables.

Payable management

According to Bizfiling (2015) effective account payable management is crucial, more importantly for small and medium scale businesses to ensure that their payables contribution is positively affected to their cash flows and support to maintain the relationship with the suppliers.

Export performance

The study on the export performance of companies started with the studies of Tookey (1964) who tried to determine the factors related to the success of export firms. According to Cavusgil & Zou (1994) and Katsikeas, Leonidou & Morgan (2000), they have stated that there are two procedures to measure export performance, which are categorized as economic aspect (Financial), and non-economic aspects (non-financial). Economic measures include sales and profits. Whereas non-economic aspects include product and market-related factors. According to the research which is done by Aaby & Slater (1989), emphasized that profit-related measures on export growth and profitability are widely used to measure the performance of exports.

Export performance has been measured by various indicators, including export sales, export growth, export profitability, export market share, attainment of export goals, export intensity, and perceived success among competitors (Zou, Taylor & Osland, 1998).

Statement of problem

According to past research the contribution of small and medium export enterprises in other Asian countries were higher compared to the contribution of small and medium export enterprises in Sri Lanka. Furthermore, out of total number of exporters in Sri Lanka 82% are Small & Medium Enterprises but the contribution to the total exports is only around 5% (Mudalige, 2017). Based on exploratory research conducted, it is stated that in other countries there are many reasons behind the low contribution to exports by Small and Medium Enterprises (Huda, 2013; Ackah & Vuvar, 2010; Yoshino & Taghizadeh-Hesary, 2016).

Among these all reasons, working capital management issue has been highlighted in many research as the main reason for the low contribution to exports. There is an inverse relationship between working capital practices and profitability (Deloof, 2003). It is stated by using correlation and regression analysis, that a significant negative relationship is found between the firm's profitability and its liquidity level (Eljelly, 2004). These research examples depict that working capital management has been the main reason for the low contribution. Therefore, in this research, we aim to find the effect of working capital management on the export performance of small and medium export enterprises in Sri Lanka.

Objective

The aim of this study was to analyze the effect of working capital management practices on Small & Medium export performance.

The main objective was divided into two specific objectives as follows;

- To determine the relationship between working capital management practices & export performance.
- To analyze the effect of each of the identified practices on the export performance of companies.

Conceptualization

Working capital is the proportion which is allocated from the total capital of the company to be employed in the short term operations (Geoffrey & Elliot, 1969). It is the difference between current assets and current liabilities. Under current assets, **Cash management** is defined as the management of a firm's cash to ensure adequate cash to maintain the entity's daily operations (Akinyomi, 2014). **Inventory management** is the vital dimension in the supply chain management as it emphasizes the ability of a firm to fulfill customer needs and wants on time and to allocate quantity into planning cycles (Koste & Malhotra, 1999). **Accounts receivables** are an imperative

component of current assets. As a result of any change in their extent can influence the financial position of a company (Bellouma, 2011). Under current liabilities, **Payables management** involves balancing the benefit to gain from extending credit to customers and to find the optimal level of credit and discounts which will maximize the firm's profit. Figure 1 depicts the relationships that will be studied in this study.

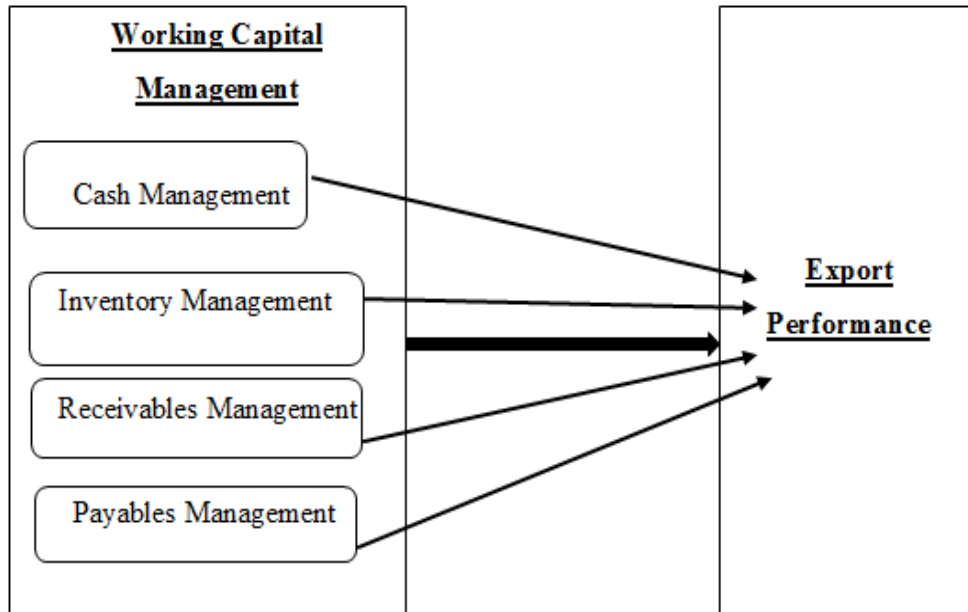


Figure 1: Conceptual Framework

DATA AND METHODOLOGY

Research design

One of the main benefits of the use of deductive research method is it use quantitative data to achieve research objectives. Therefore, in this research, deductive research design was used as this study has a specific aim to achieve, which is to find out whether there is an effect of WCM on export performance of small and medium export enterprises. In the beginning, hypothesis to achieve research objectives were developed and then a structured questionnaire to gather information from export SMEs. When working capital management of SMEs are investigated on the export performance, the export SMEs are the subject and the respondents of this research.

Sampling design

The target of this research was on small and medium export enterprises in Sri Lanka and the target population of export SMEs accounts for 3157 which are registered under the Export Development Board of Sri Lanka. The research was carried out in the manufacturing sector which focuses on the effect of WCM on export performance of export SMEs, a research questionnaire was given to the exporters that have been selected through the systematic sampling technique and those responses are collected to find out the effect of working capital management on the export performance of SMEs related to the manufacturing sector. Sample were selected from framework given by EDB on manufacturing Export SMEs related to different industries which were of 120 firms. This population of 120 enterprises listed and a sample of 60 was selected through systematic Sampling Technique. The sample was not biased as it was directly listed through the framework of the EDB, these firms are into apparel, footwear and leather, gift items and lifestyle, coconut manufacturing and boat building.

To select small and medium export enterprises for the sample following definition was used.

Table 1. Definition
SMEs: Manufacturing Sector

Criteria	Medium	Small	Micro
Annual turnover	Rs. Mn.251-750	Rs. Mn. 16-250	Less than Rs.Mn.15
Number of employees	51-300	11-50	Less than 10

Source: (Task Force for SME sector program, 2002)

Method of data collection

Primary data was gathered using the survey questionnaire method and the questionnaires were administered among selected small and medium export enterprises in the manufacturing sector. The questionnaire was distributed to the sample via e-mail where the responses were collected to the Google drive.

Measurement of variables

The questionnaire, which consists of questions regarding the basics of the company, cash management, Receivable management, Inventory management, Payables management and questions, related to reporting which tested using a likert scale. To obtain the values for central tendency measurements likert scale points are assigned as follows: 1=Never, 2=Rare, 3=Sometimes, 4=often, 5=Always. Taking a clue from the past literature, export performance measurements were assessed on five-point likert scales (Zou, Taylor & Osland, 1998).

Operationalization of variables

Table 2. Operational Chart

Variable	Question number	No. of Sub questions	Sources
Cash management	2	09	(Bandara & Rathnasiri, 2016) (Agyei-Mensah, 2011) (Bellouma, 2011) (Rathnasiri, 2015) (Caballero, et al., 2010) (Rathnasiri, 2015)
Receivable management	3	09	(Bellouma, 2011) (Bandara & Rathnasiri, 2016) (Kubickova & Soucek, 2013) (Nobanee & Abraham, 2015) (Rathnasiri, 2015)
Inventory management	4	10	(Bandara & Rathnasiri, 2016) (Nobanee & Abraham, 2015) (Rathnasiri, 2015)
Payables management	5	11	(Nobanee & Abraham, 2015)

Methodology

In the regression equation, y is always the dependent variable and x is always the independent variable. The following equation was used to mathematically describe a linear regression model;

$$Y_i = a + bX + \epsilon_i \dots \dots \dots (2)$$

Where,

Y = Dependent variable

X = Independent variables

ϵ = The residual error

The slope of the regression line (b) is well-defined as the rise divided by the run. The y intercept (a) is the point on the y axis where the regression line would intercept the y axis. The slope and y intercept is included in the regression equation. The intercept is usually known as a constant, and the slope is defined as the coefficient. An error term is included in the equation as the regression model is not a perfect interpreter. In the regression equation, y is always the dependent variable and x is always the independent variable. When higher the R-squared it is better and the model fit to the data set. ANOVA is also widely used as the statistical technique for test of significance of hypothesis. (Ogee, et al., 2013).

RESULTS AND DISCUSSION

Regression

Table 3. Results of Regression (Model Summary)

Model	R	R Square	Adjusted R Square	Std.The error of the Estimate
1	0.904 ^a	0.818	0.815	0.39346

Note:a=Dependent Variable-Mean of company's Export Performance;b=Predictors:(constant) Mean of working capital management

The independent variables that were studied, explained 81.8% of export performance as represented by the R-squared. Therefore, this depicts that the independent variable contributes 81.8% to export performance, while other variables which are not studied in this research contributes 18.2% to export performance.

Table 4. Anova

ANOVA^a

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	40.324	1	40.324	260.473	.000 ^b
Residual	8.979	58	.155		
Total	49.303	59			

a. Dependent Variable: Mean of company's Export Performance

a. Predictors: (Constant), Mean of Working capital

Note: a=Predictors: (constant) Mean of working capital management

In this case, analyze the relationship between working capital management and export performance. From the ANOVA statistics in table 4, data from the selected sample from the population had a significance level of 99% which shows these data is best for making a conclusion on the population.

Table 5. Regression Statistics

	β	SE	T	Sig
Constant	0.292	0.118	2.477	0.016**
WCM	0.620	0.038	16.139	0.000**

Note: β =Beta; SE=Standard Error; Sig=Significant Value; $R^2=0.818$. The dependent variable is Export Performance of SMEs. * $p<0.05$, ** $p<0.01$

The coefficient of regression of above Table 5 was used to develop the below equation;

$$Y = 0.292 + 0.620WCM \dots \dots \dots (3)$$

Using this model, when one unit of working capital management increases it will lead to a 0.620 increase in export performance.

According to the model, P-value (significance) of working capital management which is less than 0.05 that means alternative hypothesis is accepted which is *H1: There is an effect of working capital management on the export performance of export SME.*

Table 6. Results of Multiple Regression (Model Summary)

Model	R	R Square	Adjusted R Square	Std. The error of the Estimate
1	0.931 ^a	0.867	0.857	0.34522

Note: a=Dependent Variable-Mean of company's Export Performance; b=Predictors:(constant) Mean of cash, Mean of Receivable, Mean of Inventory, Mean of Payable

The four independent variables that were studied, explained 86.7% of export performance as represented by the R-squared. Therefore, this depicts that the four independent variables contribute 86.7% to export performance, while other variables which are not studied in this research contributes 13.3% to export performance.

Table 7. Anova

ANOVA ^a					
Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	42.748	4	10.687	89.674	.000 ^b
Residual	6.555	55	.119		
Total	49.303	59			

a. Dependent Variable: Mean of company's Export Performance

b. Predictors: (Constant), Mean of Payable, Mean of cash mgt, Mean of inventory, Mean of Receivable

Note: a=Predictors :(constant) Mean of cash, Mean of Receivable, Mean of Inventory, Mean of Payable

From the ANOVA statistics in table 7 data from the selected sample from the population had a significance level of 99% which shows these data is best for making a conclusion on population. This statistics test gives an F value of 89.674, which shows the overall model is significant.

Table 8. Regression Statistics

	β	SE	T	Sig
Constant	0.009	0.104	2.694	0.009**
CM	0.396	0.207	1.912	0.061*
RM	-1.143	0.297	-3.848	0.000**
IM	0.736	0.245	2.999	0.004**
PM	0.620	0.260	2.384	0.021**

Note: β =Beta; SE=Standard Error; Sig=Significant Value; $R^2=0.867$. The dependent variable is the Export Performance of SMEs. * $p<0.05$, ** $p<0.01$

The coefficient of regression of above Table 8 was used to develop the below equation;

$$Y=0.009 + 0.396CM - 1.143RM + 0.736IM + 0.620PM \dots \dots \dots (4)$$

Using this model, when all four factors (cash management, receivables management, inventory management, and payable management) are constant at zero, export performance was 0.009 in the regression model.

Findings of data analysis revealed that all other independent variables are constant and when one-unit of receivable management increases it will lead to an 1.143 decrease in export performance; when one unit of inventory increases it will lead to an 0.736 increase in export performance; when one unit of payable increases it will lead to an 0.620 increase in export performance.

According to the model, P-value (significance) of cash management is 0.061 which is greater than 0.05 that means alternative hypothesis is rejected which is **H2**: *There is an effect of cash management on the export performance of export SMEs* and all other three variables were significant because their P-value is lower than 0.05, therefore, the following hypothesis was accepted;

H3: *There is an effect of inventory management on the export performance of export SMEs*

H4: *There is an effect of receivables management on the export performance of export SMEs.*

H5: *There is an effect of payables management on the export performance of export SMEs.*

Interpretation of results

The developed regression in this study; working capital management explained 81.8% of the export performance of manufacturing SMEs. According to the past literature, there is an inverse relationship between working capital and profitability (Deloof, 2003). The past literature explained that when the working capital is increasing, the firm's profitability is also decreasing.

Independent variables that were studied in this research (cash management, receivables management, inventory management, and payable management) explained 86.7% of the export performance of manufacturing companies listed in the Export Development Board of Sri Lanka as presented by R-Squared (0.867).

According to Deloof (2003), it depicts that coefficient of the account receivable is negative and highly significant and an increasing number of account receivable days will lead to decrease in operating income by presenting the negative relationship between the operating income and the period taken by the firm to receive account receivable

payments. The findings of this study confirmed the finding of Robinson, Logan & Salem (1986) which argued inadequate inventory management is a major source of SMEs failure due to inadequate inventories to send goods as per the requirements of customer orders. Further, this study is in line with Amoako (2013) who stated, SMEs do not maintain an accurate payable record that leads to delay in supplier payment and if the company could manage payable accurately the efficiency of the company will be increased.

According to the results, there is a positive relationship between working capital management of SMEs and their export performance. Based on the results, export performance can be increased when the SMEs maintaining working capital management properly.

RECOMMENDATION AND CONCLUSION

Conclusion

In considering the results of multiple regression analysis, cash management has a positive but insignificant effect on the export performance of SMEs. Receivables, inventory, and payables have a positive significant effect on the export performance of the selected sample of SMEs.

From this result, the objective of analyzing the effect of each of the identified practices on the export performance of companies is achieved. All four variables of the working capital contribute 86.7% of the export performance when considering WCM as a single variable, working capital management contribute 81.8% (R square) of the export performance of an SME.

Therefore, the conclusion can be made as working capital management of firm's has an effect on their export performance.

Recommendation

According to the results, In order to enhance the export performance of an SME through Working Capital Management Practices. If firms do not review their inventory level, inventory age analysis, and inventory turnover. It can be also advised to have a cash budget that leads to track the cash inflows and cash outflows. SMEs must review banks before going into loans and other credit facilities as it supports the firm to distinguish the different facilities and policies of each bank and identify the suitable bank for their purpose. The SMEs have to keep a track of the debtor age analysis, Receivables turnover and reviewing the overdue debtors by calculating those ratios. In order to have a proper management, the companies should use these ratios.

Apart from what firms have to do, EDB can conduct training programs to SMEs on how to adopt and implement WCM practices on cash management, receivable management, inventory management, and payable management.

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APPENDICES

Regression

Export Performance Vs. WCM

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.904 ^a	.818	.815	.39346

b. Predictors: (Constant), Mean of Working capital

ANOVA^a

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	40.324	1	40.324	260.473	.000 ^b
Residual	8.979	58	.155		
Total	49.303	59			

a. Dependent Variable: Mean of company's Export Performance

c. Predictors: (Constant), Mean of Working capital

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.292	.118		2.477	.016
Mean of Working capital	.620	.038	.904	16.139	.000

a. Dependent Variable: Mean of company's Export Performance

Export Performance Vs. Cash, Inventory, Receivable and payable management

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.931 ^a	.867	.857	.34522

a. Predictors: (Constant), Mean of Payable, Mean of cash mgt, Mean of inventory, Mean of Receivable

ANOVA^a

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	42.748	4	10.687	89.674	.000 ^b
Residual	6.555	55	.119		
Total	49.303	59			

a. Dependent Variable: Mean of company's Export Performance

b. Predictors: (Constant), Mean of Payable, Mean of cash mgt, Mean of inventory, Mean of Receivable

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.279	.104		2.694	.009
Mean of cash mgt	.396	.207	.582	1.912	.061
Mean of Receivable	-1.143	.297	-1.665	-3.848	.000
Mean of inventory	.736	.245	1.090	2.999	.004
Mean of Payable	.620	.260	.906	2.384	.021

a. Dependent Variable: Mean of company's Export Performance

