FINANCING WORKING CAPITAL IN A DEPRESSED ECONOMY:

A CASE STUDY OF WEST AFRICAN MILK COMPANY NIGERIA PLC

BY

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NOVEMBER, 1999

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NOVEMBER, 1999

DECLARATION

I hereby declare that this project work is the project of an original study, conducted by me under the supervision and guidance of Mallam A. M Abu Abdissamad.

I therefore accept responsibility for all errors and omissions therein.

OLUKA DONATUS		25-09-2000
NAME OF STUDENT	SIGNATURE	DATE

DIGITIZED

CERTIFICATION

The thesis financing working capital in a depressed economy, stripped by Oluka Donatus meets the regulations governing the degree of masters in Business Administration (MBA) of the Ahmadu Bello University Zaria is approved for its contribution to scientific knowledge and literally presentation.

25/9/00

Project Supervisor Date

25/9/00

Head of Department Date

18/11/03

Dean, Post Graduate School Date

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DEDICATION

This project is dedicated to Mr. Charles Oluka, Louis Oluka and Francis Akpati, for their moral and financial support.

ACKNOWLEDGEMENT

Research work of this nature is no doubt, an energy sapping and time consuming venture. This research work could not have been successful without the help from other people. To this end, I am grateful to those who had in one way or the other contributed to the success of this work.

I wish to first and foremost thank Almighty God for the life, wisdom, love and knowledge given to me in the pursuance of my noble goal.

My special appreciation goes to my supervisor, Mallam A. M Abu Abdissamad for his untiring efforts and support to ensure that this project becomes a success. And also wish him another successful tenure as the Head of Department of Business Administration, as he had always stood for justice and fair play.

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ABSTRACT

There is no one generally or universally accepted definition of "Working Capital." Working capital may mean, "those funds used in acquiring current assets, "but for the purpose of this study, working capital is defined as the excess of current assets over current liabilities. Current assets include: Stock, Cash. Marketable securities, Accounts Receivables while current liabilities include: Notes Payable, Bank Overdraft, Accruals, Trade Creditors, short-term Loans.

West African Milk Company Nigeria Pic, like any other manufacturer operates in a depressed Nigerian economy characterised by high inflation, massive unemployment, depreciating Naira value, low capacity utilisation, high interest rate, etc.

The technique adopted in this project was examination of company's records and accounts coupled with direct observation of its day-today activities.

For any company to meet its short term obligations, there must be enough working capital. This is therefore the bedrock for the company's effective and efficient performance.

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CHAPTER ONE

1.1 INTRODUCTION

Financing could be defined as the administration of a firm's resources to achieve organizations objectives. This could be either to acquire assets or repay liabilities. The maintenance of an acceptable or a satisfactory level of working capital which is of paramount importance to business organisations is the centre point of this study.

For a smooth running and operation of an organisation, especially the manufacturing concern, adequate cash balance has to be maintained, stocks need to be purchased and accounts receivables need to be maintained. All these require money and can be financed in many ways. These include: banks, short term borrowing from financial institutions, trade credits and other short term borrowings. On the whole, maintaining an optimum level of net working capital that is in excess of current assets over current liabilities is what is required of a business.

1.2 STATEMENT OF THE PROBLEM

From the prevalent conditions in business organisations and especially manufacturing concerns, one is aware of the fact that working capital is the most veritable tool to its continued existence and survival.

At the West African Milk Company, the problem of total dependence on imported raw materials owing to the non-availability of local substitutes, therefore sufficient financial resources are needed to finance raw material stocks in the store and those in transit due to lead time of about two months. There is also the enormity of the scarce foreign exchange requirements needed to establish letters of credit after sourcing the required funds in the local currency.

The distribution network for its products are numerous and mostly on land as a result enough cash is required for fuelling and maintaining the delivery trucks.

1.3 PURPOSE OF STUDY

The purpose of this study is as follows:

(i) To critically analyse the needs of working capital financing in West African Milk Company and make suggestions that would further improve working capital financing based on the theoretical framework- in earlier researches taking into considerations the peculiar circumstances surrounding the production operations in West African Milk Company.

(ii) To determine whether or not there is need to finance working capital through bank loans in a depressed economy.

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1.4 SCOPE OF STUDY

The study attempts to provide an orderly framework for analysing the operations of West African Milk Company from inception to date. The study covers the financing of raw material stock through banking institutions like overdrafts and short term facilities.

The project will be supported by the Audited Financial Statement for some years. The scope of this project will therefore examine how working capital financing aids effective and efficient operations.

1.5 RESEARCH METHODOLOGY

There are four methods or techniques of conducting research into a problem. These are: Experimental, Documentary, Descriptive and Case Study.

For the purpose of this study, case study is used. A case study involves focussing on only a marginal part of the population in order to draw inferences from them, for the population. Case study provides for intensive research as opposed to extensive research. It is to be noted that because case study focuses on only one case, one can only draw lessons but not generalisations. This is a limitation to this study. However, with careful thoughts and necessary adjustments the effect of this limitation can be minimised when extrapolating to the whole population.

Method of Data Collection:

Data collection is an activity aimed at generating information to satisfy some decision objectives.

For the purpose of this study, structured personal interview was employed on the assumption that relevant information would be obtained.

An analysis of the company's financial statements was carried out from 1995 to 1998.

1.6 LIMITATIONS OF STUDY

This research is being carried out to identify how working capital is financed in West African Milk Company Nigeria Plc. So it is a study of one manufacturing firm only. It is therefore not possible to compare the result of findings in this company with another. Hence the data analysis can only be generalised with utmost caution. So the scope of the study would be restricted to West African Milk Company Nigeria Plc.

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CHAPTER TWO

LITERATURE REVIEW

Many writers and researchers have done much work in this area of financing, i.e. working capital. But persistent changes in business world has made working executives pay much attention to future operations. Unstable rate of exchange of the Naira to major world currencies, prices of raw materials and other factors have made business managers plan properly before taking decisions.

This chapter on review of related literature will be based on earlier researchers work done on this topic.

2.1 <u>HISTORICAL BACKGROUND OF THE COMPANY</u>

West African Milk Company Nigeria Plc., was incorporated on the 17th April, 1973 as a private limited liability company, to manufacture, process, pack and distribute various milk products in Nigeria. In compliance with the Nigerian Enterprises Promotion Decree in 1978, the company became a public company under the Second Schedule of the Decree. From that moment, the Nigerian shareholding was increased to 60%. The balance of 40% is 36.67% held by Cooperative Company Friesland, Holland (CC Friesland) and 3.33% by Pierson Melenier & Co. Ltd., Manchester, U.K., a subsidiary of CC Friesland. The

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Nigerian 60% equity shareholding is beneficially owned by about 141 individuals and institutional shareholders.

The company, the only one producing evaporated milk in Nigeria, went into production on the 25th of August, 1975 when the Rainbow brand of evaporated milk was produced. Rainbow as a brand name was later dropped for "Peak" and "Black and White," another brand, "Three Crown" evaporated milk was introduced in 1988.

The company's factory is located on an 8.312 acre piece of land at the Ogba Industrial Area, Ikeja. At inception, the company had an installed production capacity of 1.2 million cartons of 96x70 grams evaporated milk per annum. This capacity was increased to 2.5 million in 1982.

To ensure that the products reach consumers, the company maintained a highly efficient network of distribution, comprising appointed distributors, spread over the 36 states of the federation and the Federal Capital Territory, and some West African countries, including individuals and main marketing companies.

The company's staff strength is about 1,000. In appreciation of the vital role human resources play in the success of any company, for this reason, the company undertakes continuous formal and informal training of its staff both locally and abroad from time to time.

West African Milk Company's technical partner is the Cooperative

Company Friesland (CC Friesland) in Holland. It is one of the foremost dairy cooperatives in Holland with about 25 affiliates all over the world.

2.2 MANAGEMENT

The management of the company is headed by an expatriate Managing Director who is a Dutch national. He is being assisted by a Production Director, Financial Controller, General Manger, Assistant General Manager Marketing, Production Engineer. The management team comprises expatriates and Nigerian nationals. The management oversees the day-to-day operations of the company. They have tremendous individual capabilities and the required expertise in the management of a manufacturing concern due to their consistent training at home and abroad.

2.3 WORKING CAPITAL

DEFINITIONS

Working capital could be defined as a firm's current or circulating assets. Current assets have been defined as assets that can be easily converted to cash within the current accounting year, or near cash resources. The value represented by these assets circulates among several balance sheet items. Cash is used to purchase raw materials, pay for labour and the manufacturing costs to produce goods, these goods are then carried as inventories. When these inventories are sold, accounts receivables are created. Then when these receivables mature cash is collected and the process starts all over again.

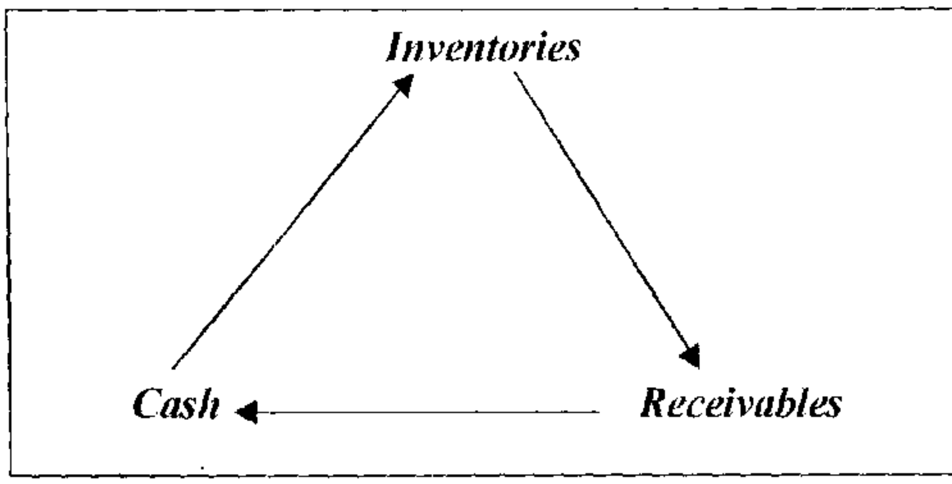

Fig. 2. 1: *Circulating Nature of Assets*

A firm's working capital comprises of two types:

(i) **Variable Working Capital**

These represent additional assets required at different periods of time during the operating year. At peak periods, additional inventories must be added to supplement the available inventories to meet up the demands of the customers. This also increases receivables which must be financed. So extra cash may be needed to finance this increased supplies.

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(ii) Permanent Working Capital

This represents the current assets required for the running of the company on a continuing basis throughout the accounting year. It represents the amount of cash, inventory and receivables maintained to carry on with the firm's operations throughout the year. Therefore, this represents the optimum level of working capital to be maintained.

> "Current assets by accounting definition, are assets normally converted into cash within one year"[1]

James C. Van Home went further to state that working capital involves the administration of these assets namely: cash, receivables, marketable securities and inventories - and the administration of current liabilities.

It can be deduced therefore that networking capital is excess of current assets over current liabilities.

Raymond P. Kent also agreed with James Van Home's definition that current assets are cash and other kinds of assets that will be easily converted into cash in the ordinary course of business within one year.

However, Raymond P. Kent was silent on current liabilities, but he distinguished between current assets and fixed assets. He stated that in keeping with the definition of current assets in terms of the one year, he therefore defined

1 James C. Van Horne - Financial Management anti Policy (Seventh Edition) 1986, pg. 3 91

fixed assets as:

> Those assets that will not be completely converted into cash in the ordinary course of business within one year.[2]

According to Mehta Dileep R., components of current assets or working capital, consist of cash and marketable securities, inventories and accounts receivables. These assets are short-lived: typically their life span does not exceed one year. This is gross working capital.

> Net working capital is defined as current assets less current liabilities.[3]

Another author, Charles W. Gersterg, agreed that the meaning of the working capital is restricted to the excess of current assets over current liabilities.[4]

One author also sees net working capital for investment appraisal purposes as: stock added to debtors and cash less creditors and trade bills, bank overdrafts and other short term borrowings to arrive at net working capital.[5]

From the above definitions, current liabilities differ from others defined for normal accounting purposes. The later normally include dividends and tax

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2 Raymond P. Kent - Corporate Financial Management, pg. 88
3 Mehta Dileep R., Working Capital Management, (1974) pg. 1
4 Gester Charles W., *Financial Organisations and Management in Business*. Pg. 282
5 Gester Charles W., *Financial Organisations and Management in Business*. Pg. 282

payments due to be paid within a year. He went further to say that tax payment is excluded because they are deducted from profits in computing the net cash flows, and that to treat them also as a source of finance would be double counting the benefit from delayed tax payment.

Dividends due are excluded as a source of finance because they form part of net cash flow earned by a company and cannot therefore be treated also as a source of finance for the project to which they relate.

Net working capital is the net sum which has to be financed from long term capital, that is, shareholders fund plus long term debt.

From Gester's point of view, with regards to investment appraisal, it looks correct. But personally, I view current liabilities as those that are payable within one year including tax payments and dividends. This stems from the fact that while those payments are deducted from profit, but they are yet to be paid, constitute a source of finance to the firm. If they are paid out immediately, then it would have reduced cash.

> "The difference between the total of the current assets and the total of the current liabilities represents the net current assets/liabilities or working capital of the business."[6]

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[6] P. A. Elliot - *The Bank Managers Handbook*, (1987) pg.87.

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Working capital is synonymous with current assets and refer to the excess of current assets over current liabilities as net working capital.[7]

One author also suggested that working capital means current assets minus current liabilities and that it is redundant to add the term "net" to it.[8]

There are two concepts of working capital: gross concept and net concept. The gross concept refers to the difference between current assets and current liabilities. Net working capital can be positive or negative. It is positive when current assets exceeds current liabilities and negative when current liabilities exceed current assets.[9]

In conclusion, it could be said that working capital represents the excess of current assets over current liabilities. As the activities of current assets are interwoven with that of current liabilities. For example, we can purchase materials for cash or on credit. When purchased on credit, stock is created while current liability is also created from the accounts payable that resulted from such credit purchase.

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[7] Herbert T. Spiro - *Finance for the Non-Finance Manager* (1975) pg. 121.
[8] Weston and Brigham - *Essentials of Managerial Finance* (Sixth Edition) pg. 165.
[9] I. M. Pandey - *Financial Management* (Second Edition) 1981, pg. 325.

2.4 CHARACTERISTICS OF WORKING CAPITAL

(i) Assets Forms and Activity Levels:

Current assets provision and availability does not tally with its uses. As a result it is not instantaneous and synchronised. For example, when raw materials are purchased with cash, this involves cash outflow - a current asset. This raw material will not be used immediately until after some period of time. When these materials are now processed into finished goods and subsequently delivered to customers, there would have been a time lag between the purchase of raw materials and the emergence of finished goods. Customers on their own part may purchase these goods on credit and payment may take some weeks or months. So it is obvious that the whole cycle of transactions do not occur at the same time.

Another characteristics of working capital is that their life span depend upon the extent to which production, distribution or sales and collection are uninstantaneous and unsynchronised. This means that the production cycle and the credit period affect the life span of working capital.

(ii) Short Life Span:

The life span of working capital is relatively short, perhaps up to one year. This is the general assumption but in practice it is at times shorter than one year.

Trade debtors are expected to settle their debts between 30 days and 60 days, while stocks are to be consumed in production in accordance with the production cycle. Then finished goods are consumed, the moment they are delivered to customers in normal course of business.

(iii) <u>**Swift Transformation and Interrelated Assets Forms**</u>

Current assets are not permanent in nature. They change from one form to another form in a very rapid form. This their transformation is closely interwoven. For instance, when raw materials are purchased on credit, trade credit which is a current liability is created, this raw material stock is immediately or later processed into finished goods and stock of finished goods is created, when the stock of finished goods are sold, cash can be created or trade credit is created as the case may be.

2.5 <u>FACTORS AFFECTING WORKING CAPITAL NEEDS</u>

(i) <u>**Cyclical and Seasonal Factors:**</u>

The demand for products or services portend seasonal fluctuations. When the demand for a firm's products or services is high then the firm will have to keep high working capital to cope with the volume of business. And when demand or sale becomes low invariably, the working capital required would be low.

Generally, business activities react to the overall performance of the nation's economy. Hence during boom there is high demand for goods and services and this in turn means high production and sales by producers. While, there is less demand during recession.

(ii) **Sales Volume:**

The volume of sales or turnover of a business determines the level of income to be realised. Therefore, the higher the volume of sales, the higher the level of working capital required for carrying out production and other related services. Normally, there is an industrial average level of current assets to annual sales ratio. This ratio is between 20% and 40%.

(iii) **Change in Technology:**

Changes in production techniques may reduce or increase material usage and other related services to productions of goods and services. This in turn affects the level of working capital needs.

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(iv) **Company Policy:**

The policy of a firm greatly affects the working capital needs. For example, changes in credit policy will no doubt affect the working capital levels of a firm. If credit period is increased from 30 days to 60 days, there should be a corresponding increase in working capital required for running the firm, as cash will not be realised within a short period. Also, if the policy becomes shorter and credit period is reduced from 60 days to 30 days, less working capital will be required.

2.6 DETERMINANTS OF WORKING CAPITAL NEEDS

The amount of working capital required for the smooth running of a firm depends on several factors. Principally, these include the nature of the product, the nature of the industry in which the business operates and the size of the business activity. The main factors which determines the working capital needs of the business include:

1. Production and sales cycle,
2. Business activity level, and
3. Marketing policy.

Production and Sales Cycle

The production cycle starts with the receipt of raw materials into the stores and end when finished products have the finished look and heads for the finished goods store. The time lag between the receipt of raw materials and the finishing stage may take days or even weeks or months.

Sales cycle starts when the finished goods leave the production line and does not end until the cheques for the sales proceeds is banked. For a manufacturing company, the production and sales cycle determine the working capital required. During the interval between receipt of raw material and receipt of cheque from the customer, the company ties down its resources in raw materials, work-in-progress, finished goods stock and debtors. So, in deciding the working capital required, this time span must be properly taken into consideration.

Business Activity Level

This is another important factor in calculating the working capital requirements of the business. The level of activity will determine:

1. The level of raw material stock that should be held.
2. The staff strength required for the production.
3. The level of finished stocks needed to meet the planned sales. KASHIM IB
4. Accounts receivable and
5. The size of credit the company will obtain from suppliers.

Level of Raw Materials Stock

The level of raw materials a manufacturing company will keep depend principally on the production schedule, availability of supply, and supply lead time.

Staff Strength

In some industries, the wage bill accounts for well over 50% of the production cost. In such situations, the wage content of the work-in-progress and finished stocks would be very substantial. The production length and the amount of labour cost that will be tied down in them. On the other hand, a wholesale distributor's planned sales will determine the size of stock of finished goods held by him. Apart from the cost of the goods, the only other cost he may have to bother about is the overhead expenses.

Finished Stocks Level

The production schedule and sales demand will determine the stock of finished goods that the business keeps. However, it must be remembered that the production schedule is based on projected sales demand and the planned level of stock the business wants to keep to provide back-up for sales.

Accounts Receivable

It is a common saying that "nothing happens until sales are made." The end purpose of production schedules, purchases programmes and stock level control, is to ensure adequate supply of stocks to meet sales demand.[10]

Sales create accounts receivable. The size of accounts receivables depend on the sales level and credit terms. If the business plans high sales and allows credit, the accounts receivables will be high.

Accounts Payable Size

Basically, what the company wants to sell will determine the purchases for stock the company has to make. If planned turnover is high, the purchases for stock will be high and this means high accounts payable if the company takes advantage of credit facilities from the suppliers.

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Marketing Policy

Most of the key variables of marketing mix have material effect on the working capital needs of the business. For example, it is commonly known that price, credit terms, advertising, etc. influence customer's effective demand for the company's products. Effective demand means high sales revenue. The following

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[10] S. O. Ibitoye, *Managing Your Working Capital* (1985) pg. 77.

marketing decisions will have material effects on the working capital need of a business.[11]

Unit Price

"Price moves the product" is a common saying. A company may price its product out of the market if it is too profit conscious. On the other hand, a well priced product could turn consumer indifference to consumer preference. This give adequate profit margin and working capital requirements will be reduced as cash generated from the profit margin will go a long way towards reducing the working capital required.

Advertising

Advertising and sales promotion are expensive marketing strategy. A well planned and coordinated advertising and sales promotion effort may move even the worst priced products. The high volume of demand that accomplish this strategy will result in the reduction of working capital need, but where the strategy fails, it will increase the working capital need.

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[11] S. O. Ibitoye, *Managing Your Working Capital* (1985) pg. 77.

Credit Terms

Credit terms have the main motive of inducing quantity demanded by the customers, unless this objective is achieved, it may turn out to be a source of working capital drain.[12]

2.7 BUDGETING WORKING CAPITAL NEEDS

Working capital needs could be estimated in the following ways:

(i) Inventory:

One month's supply of each of raw materials, semi-finished materials and finished materials plus receivables. One month sales plus operating cash. One month's total cost.

The semi-finished materials is calculated by adding one month's raw material supply is calculated plus one-half conversion cost.

The finished goods is one month's raw materials supply plus one months semi-finished goods plus one months finished goods cost. The totality of the above three calculations gives the inventories value of working capital. This method gives details of working capital items, but this approach is subject to error if markets experience fluctuations.[13]

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[12] I. M. Pandey - *Financial Management* Second Edition (1981) Vicas Publishing House, PVT Ltd. Pg. 331.
[13] I. M. Pandey - *Financial Management* Second Edition (1981) Vicas Publishing House, PVT Ltd. Pg. 339.

(ii) **Percentage of Annual Sales Figures:**

For example, 20% - 30% of annual sales. This method has a limited reliability because its reliability is dependent on sales estimate accuracy.

(iii) **Percentage of Fixed Capital Investment:**

10% - 20% of fixed capital investment. This method cannot be relied upon if investment estimates is preliminary or not accurate.

Conclusively, a number of factors govern the choice of method used in practice. For example, seasonal variations in operation, accuracy of sales forecast, production cycle, credit and collection policy of the firm, variability of sales price. All these would have an impact on working capital requirements.

2.8 SOURCES OF WORKING CAPITAL

Sources of finance for business falls into three broad categories vide:

(i) Short-term funds

(ii) Medium-term funds

(iii) Long-term funds

The use of any of the above to finance the working capital required depends on the circumstance of the business. It is generally believed that it would be preferable to finance short-term financial needs from a short-term source. This is particularly important where the shortage arose from a sudden drop off in business which is considered temporary..[14]

A firm's permanent working capital can be financed from long-term sources while the variable working capital should be financed from the short-term sources. For example, the minimum stock level a firm must maintain to enjoy a continuous production are permanent current assets which must be financed through long-term sources. Any stock above the minimum level, are variable and require short term finances.

Short Term Funds

Short term funds are loans, advances, credit facilities etc. which have a duration of about one year. They include the following:

1. Bank overdraft
2. Trade credits
3. Debt factoring
4. Acceptance credits

Bank Overdrafts

Banks by nature of their business, prefer to provide short term finance to

[14] S. O. Ibitoye, *Managing Your Working Capital* (1985) pg. 91.

the business community. This is because most of their funds are deposits by customers which can be withdrawn without notice to finance build-up of stocks to meet seasonal demands, such as stocking up for Christmas sales, to accommodate the finance of government contracts, etc.

Trade Credits

Trade credit accounts for a substantial part of the total fund of the business. It is the cheapest source of business finance, since it is ordinarily an interest-free short term loan to business. Credit arrangements with suppliers are usually entered into without the usual legal contractual documentation.

Debt Factoring

Debt factoring is a source of short term finance for the business. Under this arrangement, a factor takes on the responsibility of the company's receivables. The arrangement varies, but usually the factor on taking responsibility of the debts pays an advance of up to 80% of the value of the debt to the company and the balance settled on the average due date of the debts less services and financial charges.

Acceptance Credits

An importer of raw materials who may wish to secure regular supply of the factory input may negotiate with the suppliers to accept payment by acceptance credit. This credit is a draft issued on a letter of credit accepted by the advising bank and payable on maturing date.[15]

Medium Term Funds:

No doubt, it is a prudent financing arrangement to try to match the type of finance used with the life span of the project for which the fund is borrowed. It is desirable that at least a portion of the gross working capital be financed from medium and long term debt financing of the shareholders equity.

Bank Loans:

Banks provide the bulk of the medium-term loans for the business. The duration of the loan ranges between three and seven years.

Equipment Leasing:

Equipment leasing is a form of medium-term finance. It is an arrangement between two parties, the lessor who is the owner of the equipment and the leasee

[15] S. O. Ibitoye, *Managing Your Working Capital* (1985) pg. 99.

who hires the equipment. A company having cash flow problem and wishing to purchase a piece of equipment to replace an existing one may approach an equipment leasing company for a lease agreement. The lessor acquires the equipment with his funds and leases it out to the leasee on terms which enable the leasee to pay a fixed rental for a fixed period.

Hire Purchase Agreements:

Hire purchase is another means of acquiring an asset where the company is unable to acquire this outright from its means. Under this arrangement, the hirer pays by instalments the principal plus interest on the asset for a fixed period after which the asset is sold to him.

Long Term Funds

There are various sources of long term funds. Long term funds are either permanent or redeemable at a predetermined future date. The permanent capital of the business includes the ordinary shares, preference shares, long term debts and private savings.[16]

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[16] Hampton J. J. - *Financial Decision Making: Concepts, Problems and Cases*, pg. 132.

2.9 RISK-RETURN TRADE OFF

A firm has to weigh the risk of financing with the returns from its operations, for instance, under the conservative approach, the firm earns the lowest profit, i.e. where the firm finances part of its current assets with long-term financing.

Under the moderate approach, where the firm matches current assets financing with life of the assets, low profits are earned and under the aggressive policy, it earns the highest profit, however, the least here is greater.[17]

2.10 THE COST OF TRADE-OFF

The firm has to balance the cost of carrying working capital to its liquidity and illiquidity. The cost of liquidity has to be balanced with the cost of illiquidity, since the cost of liquidity plus the cost of illiquidity equals the total cost. Where the total cost is at the minimum gives the optimum level of current assets. Cost of liquidity is the stock holding cost while the cost of illiquidity are the stock-outs, loss of sales revenue, loss of customers patronage, etc.[18]

2.11 OPTIMUM LEVEL OF CURRENT ASSETS

For an effective financial planning and control, a financial manager need

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[17] I. M. Pandey - *Financial Management* (1981) pg. 335.
[18] I. M. Pandey - *Financiall Management* (1981) pg. 335.

to determine the optimum level of current assets so that the wealth of shareholders would be maximised. The relative structure is measured by the current assets to fixed assets or current assets to total assets. The greater this ratio, the less risky and less profitably the firm would be and vice versa.[19]

A business that has adequate working capital has the following advantages:

1. Credit is maintained due to prompt payment to suppliers.
2. Cash discount is usually obtained.
3. Banks are always willing to grant loans to a business organisation if it is adequately financed.
4. The business could meet up emergency situations.
5. This improves efficiency as stock-out is avoided, thereby increasing sales revenue.

Where a business is operating without enough working capital, this results into the following situations:

1. Business cannot earn enough returns.
2. Waste is encouraged, for example, large inventories being kept with the risk of obsolescence.

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[19] Hampton J. J. - *Financial Decision Making: Concepts, Problems and Cases*, (1976) pg. 291.

2.12 MANAGEMENT OF WORKING CAPITAL DURING RECESSION

In a period of recession, financial managers become conscious of costs and improve on efficiency. This measures become necessary to guide against incurring much debt. An organisation may change the terms of payment after sales. Special sales may help turn inventories into cash. A horizontal cut in price of products may be introduced or the use of sales promotion.

2.13 OTHER EXTERNAL SOURCES OF FINANCING WORKING CAPITAL

Commercial Finance Companies

1. Commercial finance companies
2. Sales finance companies

The commercial finance company finances the sales or assignment of accounts receivables or the pledge of inventories.

The sales finance companies specialise in discounting conditional or instalmental sales to customers.

Commercial Paper

Commercial paper refers to short-term unsecured promissory notes of large non-financial corporations. Finance paper refers to similar notes from finance companies. These papers are issued for a maturity of one month to one year. This instrument is purchased by other firms with excess cash who have a desire to earn a higher yield than may be available from treasury bills. In return for the higher yield, the firm accepts slightly greater risk and less liquidity.

These instruments can be purchased through banks or security dealers.

Unsecured Loan

When a bank grants credit to a business,interest is paid at the prevailing rate. The borrower is usually requested to have deposit with the borrowing bank. This credit is usually paid within a year and there is provision for 30 days free period within which the borrower cannot apply for another line of credit. This loan agreement provides for revolving credit term loan or stand-by commitment.

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Revolving Credit

This provides an arrangement whereby the business can borrow up to a specified sum of money between two to five years at a specified interest rate.

Unused portion of this loan attracts a small fee of about 0.5% to 10% depending on the bank. The borrower repays several times within the specified period but not exceeding the agreed amount.

Standby Commitment

The business is given the right to obtain a term loan, on a specified terms, for the business to meet up its current needs at any time within the specified period. Usually from three to five years.

The advantages peculiar to this type of arrangement is that the interest rate is predetermined over the period of the agreement and there is shield against change in the bank's policy.

Sales Discount or Pledge of Notes or Contract Receivables

Under this arrangement, the purchaser makes a down payment and signs a promissory note to pay a certain specified amount monthly. The dealer then endorses the note with security documents and take them to the finance company who pays the balance of the sales price to the dealer. This arrangement can be made with recourse or with non-recourse.

Recourse: The dealer assumes all the risk, in the event of default.

Non-Recourse: The finance company assumes all the risk. In the event of a default, the finance company repossesses the goods for a resale. If there is any loss, this must be borne by the finance company.

Pledge of Notes or Contract Receivable

Notes or contracts receivable when properly endorsed may be pledged with a bank, a finance company or other lenders as a collateral security for a direct loan.

Assignment of Funds Under Performance Contract

The existence of a specific construction, production or other performance contracts with well recognised or established company may enable the company to obtain funds for current needs, from a bank or finance company, against the assignment to the lender of funds due or to become due under the contract.

Usually, the lender will require assurance of the financial capability of the contractees and contractors's ability to complete the contract strictly in accordance with the terms.

Inventory Financing Method

This type of financing involves both financing the purchase of inventories and arrangement of loans for current needs with the company's products or inventories as collateral. The financing company may be the seller of the merchandise.

Some of the instruments used for this type of financing and methods adopted are as follows:

1. Warehouse Receipt
2. Bankers Acceptance
3. Trust Receipt
4. Factors Lien
5. Trade Acceptance
6. Conditional Sale Contract, Deed of Trust or Chattel
7. Bill of Lading

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Warehouse Receipt

Warehouse receipt could be defined as a receipt for goods placed in a warehouse which can be public or private warehouse. It is also called bonded warehouse facilities and "field warehousing" if in borrower's warehouse.

The warehouse company takes possession of the borrower's warehouse where the goods are stored. The warehouse company releases goods to the borrower upon instruction from the bank or on presentation of the warehouse receipt by the customer which is only done when the customer pays the bank or issues a trust receipt. Goods released on trust receipt when sold, the proceeds are paid back to the bank.

Trust Receipt

In this type of arrangement, buyers apply to the bank and request the supplier to draw on the bank all the documents of title to the goods. Banks pay suppliers on receiving the goods. Trust receipt agreements are then executed and documents handed over the buyer. Then when the goods are sold, proceeds from the sale is paid to the bank or finance company and the trust receipt agreement is cancelled.

Factors Lien

Under this arrangement, the factor agency lends money to manufacturers against the pledge of all raw materials, goods in process, finished goods and any other materials that the borrower may own in connection with the operation of its business.

The borrower agrees that it will, upon a reduction in its inventory, make payment to the lender on its loans, amount greater than or equal to the amount of the inventory reduction. Lenders of this sort usually inspect inventory at

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frequent intervals and are very conscious of this type of loan.

Bill of Lading

A bill of lading is a receipt given by the carriers of goods to the shipper. It shows the company who shipped the goods and the person to whom the supplier is to deliver the goods to. It also serves as a contract to deliver the goods and as a documentary evidence of title to them.

A properly endorsed negotiable bill of lading gives the holder the right to possession of the goods and therefore serve as an instrument that a bank may conveniently accept as collateral.

Advances secured by bill of lading are affected in the following ways: The seller arranges with the buyer in settlement of transactions between them. After shipment, the seller turns the draft and bill of lading over to the bank.

For sight drafts, the buyer's bank collect the draft from the bank and releases the bill of lading to the buyer who then get possession of the goods. The seller is paid promptly because it was a sight draft. Acceptance has earlier been discussed.

Advance payments made by customers for goods to be collected also serves as a means of financing working capital.

Accruals represent a spontaneous source of financing. The most common types are wages and taxes. The expense that is incurred but not paid. For example, wages are paid fortnightly or monthly, and taxes are paid yearly. Accrual represents an interest free source of financing.[20]

2.14 INTERNAL SOURCES OF WORKING CAPITAL

Internal sources of finance is very important as it constitute the primary source of cash flows into a business which determine the degree of its self financing. Some of the sources of internal financing are:

1. Depreciation
2. Retained Earnings
3. Reserves and Surplus
4. Bonus Issue

Depreciation

These are provisions made from annual profits. It does not involve movement of cash as a result, such fund is invested in stocks, cash and debtors of the firm and therefore adds to the working capital.

[20] Ralph K. O. Osayameh. *Practice of Banking*, Volume 2, Lending and Finance (1986) pg. 16.

Retained Earnings

Part of the profit earned in the previous accounting year are added to debtors, stocks and cash of the business.

Reserves and Surplus

These arise from accumulated earnings of previous years and surpluses arising from share issue or asset disposal that generates ready cash for the business.

Bonus Issue

This refers to the capitalisation of retained earnings of the business. This is also represented in the working capital.

2.15 FACTORS CONSIDERED IN SELECTING SOURCE OF FINANCE

The level of risk associated with each source of finance is considered. Unnecessary risk should be avoided.

The degree of responsiveness of the source of finance to meet up with the borrowing needs. This is important because a source of finance should be reliable to the organisation before incorporating such to its funding policy.

The relative cost advantage of a source over the other sources is also

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considered. An analysis of return trade off is carried out on all the available sources of finance to enable the organisation pick the one(s) that are of advantage to it.

2.16 BORROWING FROM THE BANKS

A prospective borrower needs to have good knowledge of the way in which banks operate. It is obvious that huge amounts of lending decision is taken at the bank's head office. It is therefore important to ensure that the loan application is detailed and formal enough to attract the needed attention.[21]

Loan agreements impart some restrictive constraints. The idea is to protect the bank against future risks, the banks therefore usually request in-depth information from the following areas from prospective borrowers.

1. Past Audited Accounts for two or more years (where applicable).
2. Brief history of the company.
3. Main operations and the locations of each branch.
4. The market for the company's products.
5. Principal sources of the company stocks
6. Management - the Board, the Executives and other cadres
7. Financial statistics for past years
8. Capital funding arrangement

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[21] Ralph K. O. Osayameh, *Practice of Banking*, Volume 2, Lending and Finance (1986) pg. 16.

9. Projections for the future

10. List of securities being offered

On the part of the borrower, before submitting such application for a loan, the following factors should be considered:

1. The period of the loan

2. The method of repayment

3. The security offered:

    a. Fixed charge on specific property

    b. Floating charge on all the company's assets

    c. Associated company guarantee

4. The extent of risk involved.

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The Cash Budget

The cash budget is an important tool for the firm's management. It shows the expected amount of funds which will be utilised for a given period. Such projections are essential as a tool for preventing cash shortages or temporal insolvency. It is also a financial plan that indicates when funds will be required and the amount.

The cash budget is arrived at through the projected cash receipts and disbursements for a given period of time.

2.18 COMMERCIAL BANKS

The role played by commercial banks in any economy cannot be overemphasised. In Nigeria, commercial banks in the past concentrated their activities on receipt, transfer nd encashment of deposits on demand but today these functions performed by commercial banks have been widened. Prominent among these functions are:

1. Acceptance and safekeeping of deposits
2. Granting loans and overdrafts to customers
3. Transfer of funds on the customer's instructions
4. Acting as executors and the trustee of will
5. Management of customer's investments
6. Safekeeping of important documents
7. Providing foreign exchange facilities
8. Facilitating import and export business, for example, issue of documentary credits.
9. Purchasing and sale of stocks and shares on behalf of their customers.

2.18 MERCHANT BANKS

Merchant banks were primarily set up for local and foreign trade. The activities of merchant banks includes advisory services to investors in foreign trade, export credit finance, accepting institutional deposits, fund raising on consortium basis, issue of stock, etc. Merchant banks also serve as Acceptance House - accepting Bills of Exchange to finance short term needs. They are principally concerned with the movement of goods across national borders. Merchant bank was defined as:

> Financial institutions providing specialist services like acceptance of bills of exchange, corporate finance, portfolio management or equipment leasing.[22]

So the merchant bank is also a source of working capital financing.

2.19 NIGERIAN INDUSTRIAL DEVELOPMENT BANK (NIDB)

The Nigerian Industrial Development Bank which is jointly owned by the Federal Government of Nigeria and the Central Bank of Nigeria is also a source of financing working capital. It is engaged in the provision of medium and long term finance for the public and private sector.

2.20 NIGERIAN BANK FOR COMMERCE AND INDUSTRY (NBCI)

This bank was established primarily for the implementation of the indigenisation decree. It also provides medium and long term finance for the

[22] Femi Adekanye, *The Elements of Banking in Nigeria*, Second Edition (1984) pg. 125.

acquisition, expansion or establishment of viable businesses by Nigerian corporate bodies.

2.21 OTHER FINANCIAL INSTITUTIONS

Working capital financing is also obtainable from the following financial institutions.[23]

1. Insurance companies
2. Pension Funds
3. Investment Corporations
4. Credit and Cooperative Societies
5. National Provident Fund
6. Finance Companies.[24]

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2.22 MEASURING LIQUIDITY/ADEQUACY OF WORKING CAPITAL

Firms should be liquid enough to consistently carry on with its operations. Cash is the most liquid of all assets. Since money is necessary to pay bills, labour, taxes, pay dividends, buy fixed assets, etc. a business organisation at any point in time should be able to maintain a favourable current ratio to remain in

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[23] Femi Adekanye, *The Elements of Banking in Nigeria*, Second Edition (1984) pg. 125.
[24] CBN Annual Report and Accounts for 1998.

business.

$$\text{Current Ratio} = \frac{\textit{Current Assets}}{\textit{Current Liabilities}}$$

$$\text{Quick Ratio} = \frac{\textit{Current Assets} - \textit{Inventory}}{\textit{Current Liabilities}}$$

Current assets are those assets of a firm which can be converted into cash within a short period of time, while current liabilities are short-term maturing obligations of a firm.

The quick ratio which is also known as the acid test is used to measure the liquidity of a firm.

As a general rule a 2:1 Current Ratio is considered adequate, while a 1:1 Quick Ratio is adequate for a firm.[25]

2.23 DEBTORS TURNOVER RATIO

This measures how rapidly debts are collected. A high ratio indicates a shorter time lag between credit sales and cash collection. A low ratio shows that debts are not being collected rapidly. This shows the speed at which Account Receivables is converted to cash.

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[25] M. Moshin, *Financial Planning and Control* (2nd Edition) India: Vikas Pub. House Ltd. (1981) pg. 168.

$$\text{Debtors Turnover Ratio} = \frac{\textit{Net Credit Sales}}{\textit{Average Debtors}}$$

$$\text{Average Collection Period} = \frac{\textit{Debtors} \times \textit{Months or days in a year}}{\textit{Credit Sales}}$$

This ratio enables a firm to plan its working capital financing.[26]

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2.24 THE DEPRESSED NIGERIAN ECONOMY

For about twenty years now, the Nigerian economy has been on the doldrum. This is characterised by low level of production, low consumers demand, high unemployment rate and very low per capita income. Little wonder then why the World Bank declared Nigeria the thirteenth poorest country in the world. There is thus a substantial amount of unused capacity in our industries. The average level of price is drifting downward. Business profit is low and in some cases, losses are incurred. Banks and other financial institutions which lend out money for investment purposes are not better-off too as prospective investors are afraid to invest due to the uncertainty of the economy.

While millions of people roam the streets without jobs for a long period of time, in times of major depressions, demand for consumer goods decline drastically.

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[26] J. M. Pandey - *Financial Management* (1981) pg. 349.

The following statistics were obtained from the previous years Central Bank of Nigeria Annual Report.

	1995	1996	1997	1998
Real GDP (Growth Rate %)	2.2	3.4	3.8	3.8
Manufacturing capacity utilisation %	29.3	36.8	37.2	37.2
Inflation Rate %	72.8	29.3	8.5	8.5
Average Official Exchange Rate ($/N)	21.9	22	22	22
Population Growth Rate %	2.83	2.83	2.83	2.83
Manufacturing Production Index %	136.3	138.0	138.4	138
External Debt ($ Billion)	32.5	28	27	27
External Debt (N Billion)	716	617	595	595
Internal Debt (N Billion)	79.5	84.1	92.6	97.3
Total Government Debt (N Billion)	795.5	701.1	687.6	692.3
Unemployment %	2.8	3.8	2.6	2.4

CBN Annual Report & Accounts - 1996
CBN Annual Report & Accounts - 1997
CBN Annual Report & Accounts - 1998

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From the above data it is obvious that the growth momentum from 1996 was generally sustained in 1997 and 1998 as against the average growth rate of 2.3% in the preceding three years. This could be attributed to the growth in oil and non-oil sector. Generally, the overall assessment was that growth performance of the economy continued to be weak and well below potential.

The dual exchange rate required was retained in 1997 with the official selling rate fixed at N22.00 to the US$1.00 for selected priority government transactions. Other transactions were conducted at the AFEM exchange rate which was market determined. The parallel market rates averaged N100.00 to US$1.00 in 1998.

The manufacturing capacity utilisation which fell to 29.3% in 1995 has steadily increased to 36.8% in 1996 and 37.2% in 1997 and 1998. This again is very insignificant and accounts for why the economy is still in the doldrum. This has given rise to low capacity utilisation in industries.

The Nigerian economy which has witnessed high level of inflation, reaching its peak of 72.8% in 1995 in recent years had declined to an all time lowest rate of 8.5% in 1997. The major factors that influenced the moderation in the inflation rate were the relatively good harvest of staples, sustained fiscal discipline and non-accommodating monetary policy. Producers were unable to pass the bulk of these increased cost fully to consumers in the form of higher products prices because of the effective control on aggregate liquidity and the prevailing weak purchasing power. The population growth rate has been consistent for the past four years.

The nation's external debt remained high and as a result the amount spent yearly by the country to service this debt had further compounded the economy. The internal debt which as at 1998 stood at N97.3b also made the economic growth of the country stagnant. A lot of organisations that have one claim or the other were denied necessary funds for an effective running of their operations. This has necessitated an increase in the domestic debt service payments, as well as outlays on the national priority projects.

As an off-shoot of debts owed to the domestic industries, many of this industries have no option other than to consistently carry out retrenchment exercise and further complicate the already woeful unemployment situation. Though the rate which reached 3.8% in 1996 further dropped to 2.6% in 1997.

The financial sector, though relatively experiencing a gradual growth, it is still not being able to cope with the demands of the economy.

These are the tales of woes that has characterised the Nigerian economy and further make it difficult for organisations to be adequately funded to achieve the desired growth and objectives.

CHAPTER THREE

DATA PRESENTATION AND ANALYSIS

3.1 INTRODUCTION

This chapter is considered as the most critical portion of this study. It is indeed the core of this entire research study. The chapter focuses on analysis of the collected data with a view to finding out how working capital is financed in a depressed economy. The analysis of these data will be carried out. This will deal with the analysis of the company's financial statements.

The findings and subsequent conclusions will depend on the above analysis.

3.2 DATA PRESENTATION

The following is an extract from the financial statements of West African Milk Company (Nig.) Plc., from 1995 to 1998.

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WEST AFRICAN MILK COMPANY (NIG.) PLC.
(EXTRACT FROM FINANCIAL STATEMENTS)

Year Ended	**1995**	**1996**	**1997**	**1998**
Current Assets (A)	N'000	N'000	N'000	N'000
Stock	254,746	167,865	201,438	261,869
Goods in Transit	47,021	117,439	140,926	183,203
Debtors & Prepayments	37,330	30,350	36,420	47,346
Amount due from Ass. Coy.	12,280	9,652	11,582	160,057
Foreign Currency Purchased	149,054	34,376	41,251	160,291
Cash and Bank Balances	121,516	31,612	37,934	130,332
Deposits for Import	6,302	16,063	19,276	--
	628,249	407,357	488,827	799,098
Current Liabilities (B)				
Creditors & Accruals	141,250	52,661	63,193	181,332
Bank Loans (Secured)	6,420	3,440	5,127	--
Bank Loans (Unsecured)	46,185	37,550	46,071	58,021
Bank Overdraft	8,067	23,831	27,699	40,389
Taxation	90,871	72,041	86,409	98,724
Dividends Unpaid Proposed	34,603	25,214	31,256	42,088
Amount due to Ass. Coy.	38,487	29,662	32,088	44,782
	365,883	244,399	291,843	465,336
Working Capital (A-B)	**262,366**	**162,958**	**196,984**	**333,762**
Turnover (Sales)	1,280,193	668,336	802,003	2,212,032
(Loss)/Profit Before Tax	206,511	161,961	194,353	412,000
Revenue Reserves	181,229	96,983	142,384	202,000
Retained Earnings	84,246	51,927	70,372	102,117
Depreciation	42,891	34,950	40,624	53,184
Long Term Loan	9,048	2,000	8,821	18,643

Extract from Financial Statements

3.3 SOURCES OF WORKING CAPITAL FINANCE AT WEST AFRICAN MILK COMPANY (NIG.) PLC.

The financing options revealed by the financial statements of West African Milk Company (Nig.) Plc. include: internal and external sources.

3.3.1 Internal Financing:

	1995 N'000	1996 N'000	1997 N'000	1998 N'000
Depreciation	42,891	34,950	40,624	53,184
Revenue Reserves	181,229	96,983	142,384	202,000
Retained Earnings	84,246	51,927	70,372	102,117
Working Capital	**262,366**	**162,958**	**196,984**	**333,762**

From the financial statements of the above period, it is obvious that Depreciation, Revenue Reserve and Retained Earnings constitute the internal source of financing to the company.

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Depreciation

Year	**1995**	**1996**	**1997**	**1998**
Depreciation	16%	21%	20%	15%

Depreciation as a percentage of Working Capital

Depreciation which is a provision made but does not involve the movement of cash is a significant source of internal financing of working capital. A review of the above table shows that depreciation accounts for 16%, 21%, 20% and 15% respectively of the working capital available to the company from 1995 to 1998.

Revenue Reserve

Year	1995	1996	1997	1998
Revenue Reserve	69%	59%	72%	60%

Revenue Reserve as a percentage of Working Capital

From the above figures, it is obvious that accumulated profit over the years have also contributed immensely towards the financing of working capital. The figures show that revenue reserve accounts for 69%, 59%, 72% and 60% respectively of the internally generated finance for West African Milk Company (Nig.) Plc.

Retained Earnings

Year	1995	1996	1997	1998
Retained Earnings	32%	31%	35%	30%

Retained Earning as a percentage of Working Capital

The table above indicates that retained earnings accounts for 32%, 31%, 35% and 30% respectively to the working capital for 1995, 1996, 1997 and 1998 respectively.

3.3.2 **External Financing**

Year	1995 N'000	1996 N'000	1997 N'000	1998 N'000
Creditors & Accruals	141,250	52,661	63,193	181,332
Bank Overdraft	8,067	23,831	27,699	40,389
Bank Loans	52,605	40,990	51,198	58,021
Associated Companies	12,280	9,652	11,582	160,057
Working Capital	**262,366**	**162,958**	**196,984**	**333,762**

The external sources of working capital financing include the following: creditors and accruals, bank overdraft, bank loan and funds from associated companies.

Creditors and Accruals

Year	1995	1996	1997	1998
Creditors & Accruals	53%	32%	32%	54%

Creditors & Accruals as a percentage of Working Capital

From the above table, it can be observed that creditors and accruals account for 53%, 32%, 32% and 54% respectively of the working capital for 1995, 1996, 1997 and 1998. Creditors and accruals also constitute a significant source of financing working capital in West African Milk Company. The data shows that the company rely much on credit supplies of its raw materials.

In fact, this constitutes the bulk of working capital financing in West African Milk Company (Nig.) Plc. This is the cheapest source of trade financing available to the company, since it is interest free. It is pertinent to note here that though it is commonly agreed that it is a free finance but strictly speaking, it may have both monetary and real costs.

Bank Overdraft:

Year	1995	1996	1997	1998
Bank Overdraft	3%	14%	14%	12%

Bank Overdraft as a percentage of Working Capital

From the above data, it can be observed that bank overdraft is greatly underutilised as a source of financing working capital in West African Milk Company (Nig.) Plc.

Bank overdraft accounts for 3%, 14%, 14% and 12% respectively of the working capital of the company for 1995, 1996, 1997 and 1998.

Though the company relies on bank overdraft as a source of finance, the figures shows that the part this source plays in the company's financing is very little. Despite the increasing level of overdraft facility which is certainly one of the cheapest form of finance, the overdraft granted is rising with the level of operation of the company and as such it does not constitute a monopolistic source of finance available for its operations. From the data examined above, it is obvious that the company is consistently relying on the overdraft facility, as a permanent source of finance which is contrary to the view that overdraft should be temporal especially during seasonal fluctuations.

Bank Loan

Year	**1995 N'000**	**1996 N'000**	**1997 N'000**	**1998 N'000**
Bank Loan	52,605	40,990	51,198	58,021

Bank Loan as a source of Finance

Bank loan is one of the most important source of finance available for an enterprise. From the above data, West African Milk Company derives an average of fifty million Naira worth of its finance from bank loans on a yearly basis for the period reviewed.

Part of this loan obtained from bank is used to finance its working capital. So with the economic depression in Nigeria, bank rates become high and this also results into higher cost of financing working capital as a great chunk of the revenue derived is paid back to the bank as interest on loan.

Associated Companies

Year	1995 N'000	1996 N'000	1997 N'000	1998 N'000
Amount due from Associated Companies	12,280	9,652	11,582	160,057

From the above data, amount due from associated companies forms part of its needed finance. Though the percentage of this source is very low. This sources is cost free to West African Milk Company (Nig.) Plc., but the associated companies and the Group in general bears the cost.

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3.4 WORKING CAPITAL POSITION

Year	1995 N'000	1996 N'000	1997 N'000	1998 N'000
Current Assets	628,249	407,357	488,827	799,098
Current Liabilities	365,883	244,399	291,843	465,336
Ratio of Current Assets to Current Liabilities	1.7:1	1.6:1	1.6:1	1.7:1

From the above data, the industry average ratio for current assets against current liabilities is 2 to 1. The above extract from the financial statements shows that the company's working capital is not up to the industry average ratio but it is close to it. In 1995 to 1998 it is 1.7 to 1, 1.6 to 1, 1.6 to 1, and 1.7 to 1, respectively. The balance, from my observation is augmented with loans,

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revenue reserves and depreciation.

This accounts for the reason why the company is enjoying a consistent smooth operation for the past years.

The company is currently operating at about 70% of installed capacity. The sales of the company's products is also impressive as from the above data the sales figure jumped from N196m in 1997 to N2 billion in 1998. This is attributable to increased production, overhauled sales policy and a slight decrease in the price of the company's products.

From the above analysis, further investigation on the activities of West African Milk Company (Nig.) Plc. revealed that the fluctuations in the volume of its operation and subsequent fluctuations in the level of financing available from its options is attributable to the following factors.

1. Changes in Government economic policies
2. Inflationary trend in Nigeria
3. Unstable value of the Naira
4. Changes in policies of creditor companies
5. Changes in banks' lending policies.

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The company therefore adjusts its level of operation periodically to align with available resources and prevailing circumstances.

From here, the research work now moves into summary of findings, recommendations and conclusion.

CHAPTER FOUR

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

4.1 SUMMARY OF FINDINGS

From the study carried out at West African Milk Company Nigeria Plc., it was found out that working capital financing from the company's point of view is a serious issue as the survival of the company depends on it.

The Financial Controller, the Chief Accountant and the Managing Director intermittently come together to review the operations of the company with special emphasis on its financial position.

The bulk of its working capital financing is from its creditors. The procurement of its raw materials are done mainly on credit from its foreign creditors, since the company depends on imported materials for its operations.

It was also discovered that loans from banks also constitute part of its needed finance for financing working capital. This is made up of secured and unsecured loan. The secured loan is tied to some of the company's assets, while the company also enjoys some unsecured loan due to the confidence bestowed on the company by its lenders as a result of its favourable operations over the past years. So the company is believed to be credit worthy. So loan from financial institutions constitute the second largest source of its working capital financing.

West African Milk Company Nigeria Plc., also finances its working capital from overdraft facilities provided by its bankers. The company also receive funds from its associated companies. The company maintains a high turnover ratio due to the popularity of its products based on the consistency of the quality of its products. It is obvious that they are the only indigenous company producing the highest quality milk in Nigeria. This has made it possible for the company to maintain a high liquidity position to facilitate its smooth operation.

From the study it was also discovered that the depressed Nigerian economy has curtailed the ability of financial institutions to grant long term facility in view of the risks involved in recovering such facility. The persistent fall in the value of the Naira also affects the company as the company rely on imported raw materials for its operations. The corresponding increase in the cost of raw materials as a result of this cannot be passed on to the final consumers and this had affected the company's profit.

The company spends much money in running its stand-by generator as irregularity in power supply has become a way of life in Nigeria. The persistent power failure from National Electric Power Authority has adversely affected its operations.

There is also a long delay in obtaining bank facilities. From the time an application is filed at the bank to when such is processed and approved takes a long time period. This had affected the reliance of the company on such facilities.

The political instability that have engulfed the nation until the second quarter of 1999 has also affected the company adversely. Most of the company's distributors in neighbouring West African countries like Sierra-Leone and Liberia have had to abandon business until the political tension died down. This had resulted in drop in sales of the company's product and subsequent drop in profit as compared to budgeted figures.

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4.2 CONCLUSION

An organisation without enough working capital cannot achieve its desired objective as working capital is the life-wire of any organisation, irrespective of the type of organisation, whether a manufacturing concern, trading organisation or service business.

West African Milk Company Nigeria Plc., was chosen as a case study because it engages in production activity on an area which requires adequate financial control and management to effectively carry on with its uninterrupted production cycle.

Financing working capital as had earlier been discussed includes the various ways by which funds are generated and coordinated with the activities of the company to achieve maximum profitability.

Opinion of various writers on the subject were identified in the literature review. The information collected from the extracts of the financial statements revealed the various ways in which the company finances its working capital needs.

Efforts were made to find out how the various sources of finance in the financial statements were mobilised with the assistance of the Financial Controller on the ground that the information is for academic purpose.

The financial statements for the past four years were examined to identify how the political climate and other factors has affected the company's operation.

The company's current ratio of an average of 1.66 to 1 did not meet up with the industry average of 2 to 1. Also the company relies much on imported raw materials, this area consumes much of the company's financial resources as the depreciating value of the Naira did not help matters in this regard.

From the study also, it was established that the company is not quoted on the Nigerian Stock Exchange. If it were quoted on the Stock Exchange, it would have facilitated its ability to generate funds at short interval of time.

In conclusion, it can be inferred that working capital financing is efficient to some reasonable extent in West African Milk Company Nigeria Plc., and is undoubtedly a strong weapon that has guaranteed its survival.

4.3 **RECOMMENDATIONS**

To achieve a consistent level of working capital that would guarantee an efficient running of an organisation, in view of this, the following recommendations are deemed necessary.

The company should improve on its current ratio by bringing it up to the industry average level of 2 to 1 (Current assets to current liabilities). This could be achieved by exploring the avenues of financing its working capital.

The company's reliance on trade credit should be re-examined. Though trade credits seem to be a free finance, extended credits often carry with it an inbuilt interest element. While on the face of it, it is being offered without apparent interest element, it must be realised that every business has its liquidity problem. Most business realise that it cost them money to hold liquid cash not even to talk of debtors and stocks. With this awareness, it is common to find companies building in interest cost into the price quoted for credit sales. Delay in payment of trade credits may lead to drastic measures from suppliers.

There is the need also for the company to consider acceptance credits as a source of its working capital financing. This is a situation whereby in a bid to secure regular supply of the factory input, the company has to negotiate with the suppliers to accept payment by acceptance credit. Acceptance credit is a draft issued on a letter of credit accepted by the advising bank and payable on maturing date. The buyer is able to discount the draft once it is accepted by the bank and obtain funds before the due date.

The company should try and enlist in the Nigerian Stock Exchange as a quoted company. This will make it possible for the company to generate funds from the capital market easily where necessary.

West Africán Milk Company Nigeria Plc., should try to be sourcing some of its raw materials locally as this will go a long way in reducing the amount of money spent on importation of such.

Management of West African Milk Company Nigeria Plc., should intensify its staff training programmes especially the Accounting staff to acquaint them with modern business management techniques.

Finally, the researcher is of the view that if these recommendations are implemented religiously, the task of efficiently and effectively financing its working capital will be achieved.

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