EFFECT OF CAPITAL EXPENDITURE ON WORKING CAPITAL MANAGEMENT OF SELECTED FOOD AND BEVERAGE COMPANIES IN NIGERIA

BY

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BEING A THESIS SUBMITTED TO THE DEPARTMENT OF MANAGEMENT AND ACCOUNTING, FACULTY OF ADMINISTRATION, OBAFEMI AWOLOWO UNIVERSITY, ILE – IFE, OSUN STATE, NIGERIA.
IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF MASTER OF SCIENCE IN ACCOUNTING

2015

CERTIFICATION

This is to certify that ORENUGA FUNMILAYO OLUFUNSO carried out this research work under my supervision in the Department of Management and Accounting, Faculty of Administration, Obafemi Awolowo University, Ile–Ife, Osun State, Nigeria.

…………………………………………….
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POSTGRADUATE THESIS

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ABBREVIATIONS USED IN THE STUDY

WCM – Working Capital Management

CE – Capital Expenditure

FE – Financial Expenditure

OE – Operating Expenditure

GRS – Growth Rate of Sales

CROA – Cash Received on Operating Activity

DR – Debt Rate

NLB – Net Liquidity Balance

WCR – Working Capital Requirement

OLS – Ordinary Least Square

WC – Working Capital

WCP – Working Capital Policy

NPV – Net Present Value

ABSTRACT

This study examined the trend and pattern of working capital as well as analysed the trend and pattern of capital expenditure and identified the factors that determine the effective management of working capital. It also determined the effects of capital expenditure on working capital management. These were with the view to contributing to the literature on the nature of capital expenditure and providing a policy framework on working capital management in relation to capital expenditure of organizations.

Secondary data were used for this study. The data were obtained from the Annual and Statement of Accounts of the selected quoted companies. The study sample consisted of 20 companies out of the 30 quoted firms in the Food and Beverage industry. Purposive sampling technique was used to select the firms that had been in existence before 2007 and were still in operation at the end of 2012 financial year. Data on variables such as account receivables, inventories, sales, account payables, tangible assets, intangible assets, operational expenses, total assets, financial expenses, shareholder's equity, debts (both short term and long term) and cash flow received from the companies' main activities were collected for the purpose of the study. Data were analysed using tables, graphs, correlation matrix, unit root test, Hausman test, correlation analysis and multiple regression models.

The results revealed that working capital showed an increase of 35% from 2007 to 2009 and a decrease of 60% from 2010 to 2011. The pattern for net liquidity balance dropped downward more than the working capital requirement. The results also revealed that capital expenditure showed an increase of 50% from 2008 to 2010 and kept increasing and decreasing as the values differ. The capital expenditure did not follow the same pattern with the working

capital management as the line formed a zigzag shape. Furthermore, the result showed that the factors influencing the effective management of working capital negatively but not significantly were: capital expenditure (t=-1.857916; $p > 0.05$), financial expenditure (t=-0.743399; $p > 0.05$) and growth rate of sales (t=-0.199305; $p > 0.05$). Debt rate (t=0.332684; $p > 0.05$) and operational expenses (t=0.976233; $p > 0.05$) had positive and insignificant effect on working capital management. Finally, Net Liquidity Balance had a positive and insignificant effect on capital expenditure (t=0.333748; $p > 0.05$) while Working Capital Requirement had a negative and insignificant effect on capital expenditure (t=-1.303097; $p > 0.05$).

The study concluded that capital expenditure had effect on working capital management of the selected Food and Beverage companies in Nigeria.

CHAPTER ONE

INTRODUCTION

1.1. Background to the Study

Out of every resource that an organization has, working capital is the most important or the basic because it is a vital element in any organizational setting that requires cogent attention, proper planning and management. As resources available to organizations are scarce, it is believed that the management of an organization's working capital has a pivotal role to play in the achievement of profitability and overall performance of such an entity. In the words of Farounbi (2005), working capital refers to the amount of capital, which is readily available to an organization, that is, the difference between resources in cash or readily convertible into cash (current assets) and the organizational commitments for which cash will soon be required (current liabilities). Working capital simply means the resources which a firm has at hand to run its daily operations. It provides a measure of business's liquidity, or its ability to meet its short term obligations as they come due (Emery, Finnerty and Stowe 2004). Working capital management is closely linked with the management of cash. Working Capital Management entails short-term decisions – generally relating to the next one year period – which are reversible. These decisions are not taken on the same basis as capital investment decisions rather; they will be based on cash flows/liquidity and profitability.

According to Brigham and Daves (2002), working capital management involves both setting working capital policy and carrying out that policy in day-to-day operations. It also involves making appropriate investments in cash, marketable securities, receivables, and inventories as well as the level and mix of short-term financing (Emery et al 2004). In essence working capital management seeks to maintain an optimum balance of each working capital component thereby ensuring that firms operate with sufficient fund (cash flows) that will satisfy both maturing short term obligation and upcoming operational expenses. This, therefore, makes it more glaring that working capital management has a pivotal role to play in a company's drive to achieve great (high) profitability. One can then say that decisions relating to working capital must not be taken for granted. To this end, Arnold (2005) asserts that if there is too little working capital, it results in inventories, finished goods and customer credit not being available in sufficient quantity. On the other hand, if there are excessive levels of working capital, the firm has unnecessary additional cost: the cost of tying up funds plus the storage, ordering and handling costs of being overburdened with stock. This creates a sort of imbalance in the working capital components, making their management difficult which in practice is a situation that firms (both small and fast growing ones, even multinationals) are confronted with. As a result therefore, the ultimate goal of working capital management is to ensure that firms are able to continue their operations with sufficient cash flow and satisfy both maturing short term obligations (debt) and upcoming operational expenses. Hence, Organizations should try as much as possible to meet up with this goal so as to avoid being caught up in the trap of ineffective management of working capital components.

Whenever we make an expenditure that generates a cash flow benefit for more than one year, this is a capital expenditure. Examples include the purchase of new equipment, expansion of production facilities, buying another company, acquiring new technologies, launching a research & development program, etc. Capital expenditures often involve large cash outlays with major implications on the future values of the company. The way of managing working capital efficiently varies from firm to firm since it depends on industry, the nature of the business,

business policy, strategy, etc. Thus, it is very important for an organization to understand the way to manage working capital efficiently. Making a capital expenditure will have several effects on the company's working capital, depending on the transaction which might affect the smooth day–to–day running of the business. However, in certain cases, there may be no impact; it is important to understand why. Broadly, industry characteristics, firm-specific characteristics, and the financial environment are recognized as determining factors of working capital. However, there are firms that are struggling to manage working capital since they don't have a sufficient understanding of the determining factors of working capital. In addition to growth, leverage, and the size of a company, types, and size of expenditures, such as finance expenditure, operating expenditure and capital expenditure, have different impacts on working capital.

It is necessary to understand the effect of capital expenditure on the working capital management of such companies. In actual fact, researches have not been really conducted on working capital management in relation to capital expenditure in this country and other countries which makes it necessary for this study to use panel data through multiple regressions to show the effects of capital expenditure on working capital components of a firm.

1.2. Statement of Problem

There are three major decisions made by the Financial Managers in all organizations. These are Capital Structure decision, Capital Budgeting decision and Working Capital Management decision. Of the three, Working Capital Management decision seems to be a very important component of corporate finance since it affects the profitability and liquidity of the company and it deals with current assets and current liabilities. It has been discovered that most of the companies' current assets is more than half of the total assets of the firm and firms need to manage the assets effectively for the business operation to run smoothly; This is because current assets can cause reduction in profits. In this regard, the assets need to be managed very well in order to increase the growth of the company but which may not be possible if a capital project is being invested upon (Appuhami, 2008).