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## Working Capital Management Practices of Small and Medium Enterprises (SMEs) in the Tarkwa Nsuaem Municipality of the Western Region of Ghana

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### **Abstract:**

*In a developing economy like Ghana, the contribution of Small and Medium Enterprises (SMEs) to the employment of the youth is highly recognized, but their contribution towards revenue to the national budget seems negligible. The reason is that some of the Enterprises do not manage their Working Capital as expected and this has affected the viability of their businesses. Mostly, the Operators of Small and Medium Enterprises possess limited formal education, weak managerial and financial management skills within the sector. This study evaluates Working Capital Management Practices among Small and Medium Enterprises (SMEs) in the Tarkwa Nsuaem Municipality of the Western Region of Ghana. One Hundred and Twenty (120) SMEs in the Tarkwa Nsuaem Municipality of the Western Region of Ghana were surveyed for this purpose. Statistical Package for Social Sciences (SPSS) was used to conduct several forms of analysis. The research hypothesized that among the demographic factors, only academic qualification of an entrepreneur and location of business have influence on Working Capital Management of SMEs in the Municipality. The Operators also carry out formal credit investigations before selling on credit especially for the first time. Again, the Enterprises appeared to be liquidity conscious and thus, refrain from financing long-term projects with short-term funds. One key issue the study revealed is that though the SMEs appeared to be managing their working capital well, they will do much better if they make use of entrepreneurial programmes offered by the National Board for Small Scale Industries (NBSSI) and Non-Governmental Organizations (NGOs) since these come with education and training.*

**Keywords:** Working capital management practices, small and medium scale enterprises

### **1. Introduction**

Small-Scale Businesses are engines that drive economies across states through job creation and poverty reduction (Orobia et al., 2016). Yet this sector is bedevilled by several constraints amid poor Working Capital Management Practices which continues to mar its laudable objectives. According to Abuzayed, (2012), poor Working Capital Management is a primary cause of failure among small businesses. Some Researchers, Business Executives and Managers of Small and Medium Enterprises have attributed the failure of Small and Medium Enterprises in Ghana and Africa to owner/managers inability to access credit (Fening and Park, 2008).

Studies show that Working Capital Management is more important to Small and Medium Enterprises than to larger firms (Afrifa and Padachi, 2016). Working Capital Management ensures that firms are in a position to meet their operating expenses and honour short-term obligations when they fall due; and also aids in creating value for shareholders (Ukaegbu, 2014; Shin and Soenen, 1998) as in Singh and Kumar (2017). Where Working Capital Management enhances firm's financing in general, it helps in forecasting future cash flows thereby promoting future growth (Lyngstadaas & Berg, 2016).

Improvement in Working Capital efficiency leads to increase in future earnings as the market responds positively to the improvement of Working Capital efficiency (Sharma and Kumar, 2011). Working Capital Management in Small and Medium Enterprises is essential to sustaining the life of the business. A steady flow of cash is essential to maintain a business, and sufficient Working Capital will maximize profitability; while poor Working Capital Management is one of the primary reasons for business failure (Tran et al., 2017). Efficient Working Capital Management helps a firm to maintain solvency, avoid situations of financial distress, and is critical for a firm's long-term survival (Baker et al., 2017). The shortage of Working Capital in most companies which face financial disturbances leads to bankruptcy and this is one of the main reasons for importance of Working Capital Management.

Working Capital Management approach excludes most Small-Scale Businesses especially in developing countries that do not meticulously keep financial records (Orobia et al. 2016) and these Small-Scale Businesses are generally characterized by lack of proper financial records.

The main components of Working Capital are Current Assets and Current Liabilities Pass and Pike (1987) as stated in Singh and Kumar (2014). 'Current Assets include: Stock or Inventory (Raw Material, Work-In-Progress, Finished Goods awaiting sale and delivery); Debtors (Unpaid Bills for which the profit has already been realized in the accounts); Trade Credit (from suppliers); Cash in-Hand; and Short-Term Securities. Current Liabilities include; Payment due to Trade Creditors (mainly for raw materials and other supplies); Bank Overdrafts and other Short-Term Loans; and Outstanding Tax, Dividend and Interest Obligations (Tauringana & Afrifa, 2013; Nobanee & Abraham, 2015)'.

Thus, more effective and efficient management of Cash, Account Receivable, Inventory and Accounts Payables lead to growth in Profits, Sales, Total Assets and ensure the survival of SMEs in the Tarkwa Nsuaem Municipality.

In view of the above, the Researchers established and discussed the following sources of financing Working Capital required by Small and Medium Enterprises in the Tarkwa Nsuaem Municipality of the Western Region of Ghana; Cash Management, Inventory Management, Accounts Receivable Management and Accounts Payable Management Practices. According to Sharma and Kumar (2011), an important part of managing Working Capital is maintaining liquidity for the Day-to-Day operations to ensure smooth running of the Business and meet its obligations.

According to Lyngstadaas and Berg (2016), higher levels of inventories are assumed to be connected to increased sales and reducing transaction costs, thereby promoting profitability. They however, added that having too much inventory may increase chances of goods not being sold or going over expiration date, and may increase in addition to warehouse rent, insurance security expenses and additional interest expenses on the increased financial needs to maintain sufficient inventory level. However, reducing and buying inventories only to a minimum may increase the likelihood of stock outs and the loss of customers and not receiving volume discounts may increase the cost of goods.

The term Receivable is defined as any claim for money owed to the firm from customers arising from sale of goods or services in normal course of business. Tauringana and Afrifa (2013) defined Account Receivables Management as the average numbers of days it takes the firm to collect Receivables from customers. They calculated account receivable days by dividing accounts receivables by sales multiplied by 365 days. Lyngstadaas and Berg (2016) observed that providing trade credit to customers may motivate them to buy more, and thereby increase profitability through increased sales. To offer trade credit in itself may signal trust between buyer and seller as it enables buyers to verify product and services quality prior to payment'. 'This reduces the asymmetric information between buyer and seller. By reducing account receivables will most likely make customers pay earlier, and thus increase profitability, as suggested in other studies as well (Garcia-Teruel & Martinez-Solano, 2007; Pais and Gama, 2015), Lyngstadaas and Berg (2016)'. According to Tauringana and Afrifa (2013), 'keeping accounts receivable to a minimum will also increase profitability because funds that are not tied up in accounts receivable can be left in the bank earning interest or invested elsewhere'. Similarly, Abuzayed (2012) suggests that 'Managers can create value for their shareholders by reducing the number of days of account receivable to a reasonable minimum'. Account receivables are not without costs. These could be capital cost (cost of honouring expenses before debtors settle indebtedness), default cost (cost resulting from bad debt losses) or delinquency cost (cost of extending credit to defaulting customers) or a combination of these.

According to Tauringana and Afrifa (2013), 'Account Payable is the average number of days it takes a firm to pay Trade Creditors. Account Payable Days were computed by dividing Accounts Payables by Cost of Sales multiplied by 365 Days'. Lyngstadaas and Berg (2016) indicated that 'being granted trade credit from suppliers may have the same effects as those mentioned in the explanation of account receivables above, and suppliers may use trade credit to investigate credit worthiness of customers. The expenses of prolonged trade credit will normally be calculated in the cost of goods, so by decreasing trade credit and paying early, customers lower the cost of goods for instance by receiving early payment discounts. That indicates an inverse relationship between account payables and profitability, as found in similar studies (Garcia-Teruel & Martinez-Solano, 2007; Pais & Gama, 2015), Lyngstadaas and Berg (2016)'. Payable Management is very closely related with the Cash Management. Effective Payable Management leads to steady supply of materials to a firm as well as enhances its reputation. It is generally considered as a relatively cheaper source of finance as suppliers rarely charge any interest on the amount owed. However, trade creditors will have a cost as a result of loss of enjoying cash discount on cash purchases. Thus, it can be concluded that efficient management of the above independent variables of Working Capital Management leads to good financial performance.

Many empirical studies in the field of Working Capital Management of SMEs focus on its relationship with business performance (profitability) but ignores the effectiveness of its management (e.g., Afrifa & Padachi, 2016; Singhanian & Mehta, 2017; Tran et al., 2017; Tauringana & Afrifa, 2013; Lyngstadaas & Berg, 2016; Pais & Gama, 2015; Orobia et al. 2016). Yet, the effectiveness of the role of Working Capital in business depends on how well it is being managed. 'Effective Working Capital Management is crucial as firms need to achieve high profitability without exposing themselves to liquidity problems (Yunos et al., 2015)'.

The known studies which consider Working Capital Management Practices are short of holistically addressing the salient elements associated with Working Capital Management (e.g., Narayanapillai, 2013; John, et al 2015). Augustine & Jacob, 2017; AL Smirat, 2016; Kinyanjui, et al., 2017). This study unlike others in the area of Working Capital Management, undertakes a detailed evaluation of key Working Capital Management Practices (Cash Management, Receivables Management, Inventory Management and Payables Management) among SMEs in the Tarkwa Nsuaem Municipality of the Western Region of Ghana.

## 2. Working Capital Management Practices of Small and Medium Enterprises

The problems of Small Businesses are compounded with poor management of Working Capital. Abuzayed (2012) emphasized that 'Working Capital Management is concerned with the problems that arise in attempting to manage the Current Assets, the Current Liabilities and the interrelationship that exists between them and if they are not able to maintain a satisfactory level of Working Capital, they are likely to become insolvent and may even be forced into bankruptcy'. An efficient Working Capital Management Practice has been widely acclaimed to be the solution to Small Businesses which collapse few months or years after they are set up. Over the last two decades, the Working Capital Management has been implemented in various forms and at different levels. However, it is not clear whether the problem of managing Working Capital of Small Businesses has been solved. Small and Medium Scale Enterprises (SMEs) constitute about 60 percent of the private sector of the Ghanaian economy. They therefore 'contribute significantly to the economic development and growth by providing employment opportunities for the vast majority of the workforce and increasing the nation's access to the world market.'

It is in the light of this that the Researchers conducted the study to evaluate the Working Capital Management Practices of Small and Medium Enterprises in the Tarkwa Nsuaem Municipality of Western Region of Ghana.

This study defines Small and Medium Scale Enterprises as Enterprises employing less than 29 Employees with Fixed Assets of up to Five Hundred Thousand Ghana Cedis (GH¢500,000.00) at the Tarkwa Nsuaem Municipality of the Western Region of Ghana.

## 3. Investigation

The research targeted owners of Small and Medium Enterprises employing 29 or less employees in the Tarkwa Nsuaem Municipality of the Western Region of Ghana. With the use of Simple Random Sampling Technique, One Hundred and Twenty (120) Small and Medium Enterprise Owners producing or selling general goods like, Sachet/Bottled Water, Hairdressing and Barbering, Dress Making, Electrical Services, Printing & Photocopying Centers, Transport and Mechanical Services were selected to serve as the sample population. Questionnaires were distributed to all the One Hundred and Twenty (120) SME's selected for the study. The descriptive statistics provided frequencies and measures of central tendencies of tables, chart of various subcategories such as gender, age and level of education. It was useful to know how Working Capital Management practices influence the success of Small and Medium Enterprises in the Tarkwa Nsuaem Municipality. The data gathered was then coded and analysed using the Statistical Package for Social Sciences (SPSS). Inferential Statistics was also generated to establish relationships. Further, a Correlation Matrix is constructed to show the associations between pairs of the demographic factors.

Based on the questionnaires, parameters were set to facilitate the computation and modelling of the Working Capital Management. First, in computing the Working Capital, one (1) was assigned to yes answers and zero (0) to no answers. Secondly, questions which have answers other than yes or no were rated based on their relevance to the Working Capital Management Practices. Finally, the modelling of the Working Capital was done taking into account determinants of Working Capital Management of Small and Medium Enterprises in the Tarkwa Nsuaem Municipality.

## 4. Data Analysis and Discussion

Overall, the research revealed that SMEs in the Tarkwa Nsuaem Municipality appeared to have observed good Working Capital Management Practices with Cash Management and Account Receivable Management Practices dominating their Working Capital Management activities. There were mean values of 3.18 and 3.08, and standard deviations of 1.690 and 2.223. for Cash Management and Accounts Receivables Management respectively.

Also, the research revealed that there are 6 categories of Small and Medium Enterprises that are operated in the capacities of Trading, Hairdressing & Barbering, Dress Making, Electrical Services, Printing & Photocopying Centers, Transport and Mechanical Services.

### 4.1. Descriptive Statistics of the Components of Working Capital Management

Table 1 projects the summary statistics of Working Capital Management and its four main constituents - Cash Management, Inventory Management, Accounts Receivable Management and Accounts Payable Management Practices. The Mean, Standard Deviation, Minimum and Maximum Values of these variables are depicted. The SMEs in the Tarkwa Nsuaem Municipality recorded a Mean Value of 9.88 for Working Capital Management representing the average performance of each firm in terms of Cash Management, Inventory Management, Account Receivable Management and Account Payable Management Practices. Cash Management appears to have dominated the SMEs' Working Capital Management with a Mean of 3.18 and a Standard Deviation of 1.690 which is close to zero. This implies that in terms of dispersion, the 120 observations under Cash Management are relatively closer to the Mean. The next most commonly practiced element of Working Capital Management is Account Receivable Management Practice with 3.08 and 2.223 as Mean and Standard Deviation respectively. Inventory Management Practice comes third with a Mean of 1.95 and Standard Deviation of 0.743. Similarly, the element that seems to have received least attention of the SME entrepreneurs in the Municipality is Account Payable Management Practice with a Mean of 1.67 and a Standard Deviation of 1.131.

Variable	Observations	Mean	Std. Deviation	Minimum	Maximum
Working Capital Management	120	9.88	4.461	0	18
Cash Management	120	3.18	1.690	0	5
Inventory Management	120	1.95	0.743	0	3
Account Receivable Management	120	3.08	2.223	0	7
Account Payable Management	120	1.67	1.131	0	5

Table 1: Descriptive Statistics

#### 4.2. Correlation Matrix

Table 2, shows the correlations or associations between pairs of demographic variables pertinent to SME Operators in Tarkwa Nsuaem Municipality used in the model. From the table it can be seen that there is no multicollinearity among the pairs of variables. The correlation coefficients range from -0.086 to 0.269 short of the 0.50 benchmark and these signify the absence of multicollinearity.

	WC	Xx	MS	AQ	Nb	LOC
WC	1.00					
Xx	0.118	1.00				
MS	0.595***	-0.055	1.00			
AQ	0.595***	-0.055	1.00			
Nb	0.337***	0.054	-0.086	0.093	1.00	
LOC	0.527***	-0.014	0.048	-0.043	0.011	1.00

Table 2: Pairwise Correlation Matrix

'WC represents Working Capital Management comprising Cash Management, Inventory Management, Account Receivable Management and Account Payable Management. Xx is the Sex of the SME Operator classified as Male or Female. MS implies the Marital Status of the SME entrepreneurs grouped into Married and Unmarried. AQ is the Academic Qualification of the entrepreneur classified as SSSCE or Lower Certificate Holders and HND or Higher Qualification Holders. Nb represents the Nature of Business operated by the entrepreneur seen as Sole Proprietorships, Partnerships or Cooperatives. LOC is the Location of the SME whether it is in the township of Tarkwa or its outskirts'.

#### 4.3. Effects of the Demographic Features on Working Capital Management

The results from the estimation of the specified model are shown in Table 3. The results depict the regression coefficients of the various demographic variables as well as the standard errors.

Variables				
WC	Coef.	Std. Err	t	P> (t)
Xx	-0.0180	0.7683	-0.02	0.981
MS	-0.8031	0.7283	-1.10	0.272
Nb	0.6877	1.1634	0.59	0.556
LOC	-1.5743	0.7299**	-2.16	0.033
_cons	8.4009	0.8876	9.46	0.000
Observations	120			
R-squared	0.2628	F(5, 115)	8.20***	
Adj R-squared	0.2308	Prob > F	0.0000	

Table 3: The Relationship between Working Capital and Demographic Information

The dependent variable WC represents Working Capital Management comprising Cash Management, Inventory Management, Account Receivable Management and Account Payable Management. Xx is the Sex of the SME operator classified as Male or Female. MS implies the Marital Status of the SME entrepreneurs grouped into Married and Unmarried. AQ is the Academic Qualification of the entrepreneur classified as SSSCE or Lower Certificate Holders and HND or Higher Qualification Holders. Nb represents the Nature of Business operated by the entrepreneur seen as Sole Proprietorships, Partnerships or Cooperatives. LOC is the Location of the SME whether it is in the township of Tarkwa or outskirts'.

\*\*\*, \*\* represent 1% and 5% significance levels respectively

From Table 3, 'the P-value of the F-test 0.000 is statistically significant since it is less than the value of the level of significance 0.05. The R-squared is 0.2628 meaning that approximately 26.28% of the variability of working capital ( $WC_i$ ) is accounted for by the variables in the model'.

Sex and marital status of an SME entrepreneur have a negative and an insignificant relationship with Working Capital Management. This implies that these two demographic variables are not influential in explaining Working Capital Management of SMEs in the Municipality. That is, they have no degree of influence on the quality and frequency at which the SMEs manage Working Capital as compared to other demographic factors such as academic qualification, nature of business and location of business. The results also showed that academic qualification is statistically significant and positively related to Working Capital Management. This connotes that the level of education of an SME Operator to a very large extent, determines the quality of Working Capital Management the SME practices and the frequency at which it does that. This direct relationship between Working Capital Management and academic qualification of the SME entrepreneurs also signifies that SMEs run by highly educated entrepreneurs observe better Working Capital Management Practices than those operated by lowly educated ones.

Nature of business is also found to have a positive but insignificant relationship with Working Capital Management implying that it has no explanatory power on the state of Working Capital Management in the SMEs comparable to other variables. That is, there seems to be no difference between Working Capital Management of Sole Proprietorships, Partnerships and Cooperative Societies in the Tarkwa Nsuaem Municipality.

Finally, the location of a firm essentially plays a lesser role in determining the quality of its working capital management and the frequency at which it manages Working Capital. This inverse relationship could also be construed as the farther an SME is from Tarkwa Township but within the same municipality, the weaker its Working Capital Management.

## 5. Summary and Conclusions

From the results of the study, it can be deduced that:

- Sex and marital status of Small and Medium Entrepreneurs have a negative and an insignificant relationship with Working Capital Management implying that they do not determine the quality and frequency of Working Capital Management among the firms.
- Academic qualification of SME Operators to a very large extent had direct relationship with effective Working Capital Management and determines the quality of Working Capital Management Practices.
- The nature of business is also found to have an insignificant but a positive relationship with Working Capital Management while location of business has negative influences on Working Capital Management.
- Majority of the entrepreneurs interviewed bought their raw materials from local companies. The interviewees hardly stock piled raw materials. However, they kept records of them regularly. Majority of the respondents carried out regular stock-taking, mostly on monthly basis. Inventory management however, appeared to have received little attention from the SME Operators as compared to cash management and account receivable management practices.
- Majority of the respondents sold goods on credit and some of them gave customers 7 days to settle their bills'. It was further observed that most of the SME Operators conducted formal credit investigations prior to any agreements with customers. The study again showed that majority of the SMEs purchased goods on credit and some of them were given up to 7 days to settle their indebtedness. A reasonable number of the respondents acknowledged that purchasing on credit was a major source of finance for their businesses. Most of the Respondents who purchased goods on credit negotiated with creditors to extend their credit periods.

It can be inferred and concluded from the findings that demographically, age and marital status as well as nature of business do not drive Working Capital Management among SMEs in the Municipality. Rather, it is the academic qualification of an SME Entrepreneur which does.

Convincingly, the firms practice good Cash Management and give more attention to Cash Management than any other components of the Working Capital Management.

Majority of the SMEs in the Municipality undertook regular Inventory Management and that helped them to eschew the tendencies of tying up funds in Stock. Inventory Management however, received little attention from the SME Operators as compared to Cash Management and Account Receivable Management Practices.

Generally, the SMEs in the Municipality have proven to be default-conscious and thus put mechanisms in place to appraise customers' transactions well prior to selling, to avert default risk. This is a sign of effective Account Receivable Management.

The SME Operators have been cautious of liquidity problems which engulf Small Scale Businesses and thus do not use short-term funds to finance long-term investments. They however, had the challenge of meeting supplier deadlines frequently and had to negotiate with creditors to extend credit periods. This could affect the quantity of supplies received and invariably affect their ability to meet the demands of customers.

Though, it is commendable that the business start-ups are funded with personal resources, it would be better for the SME entrepreneurs to also make good use of government entrepreneurial schemes such as those offered by the NBSSI and those of the non-governmental organizations (NGOs) since these schemes come with education and training. It is also recommended that the entrepreneurs replicate the kind attention they give to Cash Management in all other components of Working Capital Management. This will yield better results than what is currently achieved. Where there is the need for entrepreneurs to buy supplies on credit, they should negotiate for longer payment periods at the outset of the transactions so as to avoid supplier apathy emanating from the entrepreneurs' failure to meet payment deadlines. Finally, it is recommended that a similitude of this study be undertaken among SMEs in a wider locality such as Regional or National levels as a test for consistency of the findings.

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