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   STATEMENT OF THE PROBLEM

   OBJECTIVES

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   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

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CONTRIBUTIONS TO BOOKS

- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

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- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

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- Garg, Sambhav (2011): "Business Ethics" Paper presented at the Annual International Conference for the All India Management Association, New Delhi, India, 19–22 June.

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- Kumar S. (2011): "Customer Value: A Comparative Study of Rural and Urban Customers," Thesis, Kurukshetra University, Kurukshetra.

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IMPACT OF INVENTORY MANAGEMENT ON THE PROFITABILITY OF SMES IN TANZANIA

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ABSTRACT

A well-designed and implemented Inventory management is expected to contribute positively to the SMEs profitability. The purpose of this paper is to examine the relationship between inventory conversion period and SMEs profitability and determine the impact of inventory management on SMEs profitability. The dependent variable, gross operating profit is used as a measure of profitability and the relation between inventory management and SMEs profitability is investigated for a sample of 26 Tanzanian SMEs, using annual financial statements data analysis for the period 2006 –2011. This study employs Regression analysis to determine the impact of inventory conversion period over gross operating profit taking current ratio, size of the firm, financial debt ratio as control variables. The results indicate that there is a significant negative linear relationship between inventory conversion period and profitability. The relationship between two control variables viz; current ratio, financial debt ratio and gross operating profit indicate the expected negative relationship whereas the firm size indicate unexpected positive relationship. This may be due to managerial failure.

KEYWORDS

Inventory conversion period, Inventory management, SMEs Profitability.

1.0 INTRODUCTION

Small businesses are viewed as an essential element of a healthy and vibrant economy in developing countries. They are seen as vital to the promotion of an enterprise culture and to the creation of jobs within the economy (Bolton Report, 1971). Small Medium-Sized Enterprises (SMEs) are believed to provide a momentum to the economic progress of developing countries and its importance is gaining widespread recognition. In Mauritius the SMEs occupy a central place in the economy, accounting for 90% of business stock (those employing up to 50 employees) and employing approximately 25% of private sector employees (Wignaraja and O'Neil, 1999). Working capital management plays a pivotal role in the efficient functioning of SMEs. Most of the SMEs for their working capital funds depend on short term financing like bank loans over drafts etc. However, given their reliance on short-term funds, it has long been recognized that the efficient management of working capital is crucial for the survival and growth of small firms (Grablowsky, 1984; Pike and Pass, 1987). The one most important component of working capital is the inventory management. Efficient Inventory management facilitates to invest minimum funds in inventory maintaining continuity in business activity, increases the size of the business activities by increasing total sales consequently increasing recycling of funds and generating higher profitability. As against this, if management proves inefficient in inventory management, it results into higher inventory conversion period, high costs of inventory, leading to reduced recycling of funds, ultimately effecting profitability and liquidity of the enterprises. A large number of business failures have been attributed to inability of business managers to plan and control properly the inventory conversion period and inventory levels of their respective firms based on their business strategies. In Tanzania very little have been done concerning inventory management practices in SMEs. Keeping this in view and wider recognition of the potential contribution of SME sector to the economy of Tanzania, it motivates to attempt a study on inventory management in Tanzania.

The paper deals with presentation of an overview of Tanzania, role of SMEs sector in Tanzania, review of the empirical literature, Objective of the study, Methodology in terms of sample size, data source, variables used measurement of variables and estimation techniques. It also presents analysis and results of the study, conclusion and suggestion for improvement and scope for future research.

1.1 AN OVERVIEW OF TANZANIA AND THE ROLE OF SMEs

Tanzania is located in the eastern part of Africa, in the east it is bordered by the Indian Ocean and to the west it's bordered by Rwanda, Burundi, and Democratic Republic of Congo. Kenya and Uganda are its northern neighbors, while the southern neighbour is Mozambique. To the southwest there is Zambia and Malawi. The country encircles an area of 947300 square kilometres with a coastline of 1424 kilometres and is a home to some of the largest landmarks The Kilimanjaro which is the highest mountain in Africa standing at 5895 metres above sea level, lake Victoria – the world's second largest freshwater lake and lake Tanganyika – world's second deepest lake. Tanzania is known for its wildlife varieties with over fifteen national parks and game reserves around the country. The country has also abundant supplies of natural resources which include diamonds, coal natural gas, gold and a variety of gemstones. The population of Tanzania is around 41.05 million among which 21.23 million (2009 est) are considered to be labour force. All this makes Tanzania one of the world's wealthiest nations from a biological point of view. (CIA World fact book)

Despite this wealth, the country is ranked as one of the world's poorest countries as its population below poverty line recorded at 36% (2002 est), the estimated GDP per capita in 2009 was USD 1400 which is absolutely insignificant compared to that of other member country South Africa which recorded at USD 10,100 in the same year (CIA Fact book)

1.2 ROLE OF SMEs IN TANZANIA

SMEs in Tanzania contribute significantly to employment creation, income generation and stimulation of growth in both urban and rural areas, in-turn contributing to the development of the country as a whole economically, socially and even politically. It is estimated that about a third of the GDP originates from the SME sector. According to the informal sector survey of 1991, micro enterprises operating in the informal sector engaging 1.7 million small businesses consisted of about 20% of the labor force (3 million people then). Since SMEs tend to be labor intensive, they create employment at relatively low level of investment per job created. Most of unemployed people opt for entrepreneurship which falls in the SME sector utilizing local resources effectively with affordable technology adding value to the resources to the larger extent. SMEs facilitates distribution of economic activities within the economy thus promoting equitable distribution of resources better satisfying limited demands brought about by localized and small markets due to their low fixed and overhead costs. They complement large industries requirement in terms of supplements of raw material and other factors of production.

2.0 LITERATURE REVIEW

This study provides clear meaning of terms and concepts and also reviews the findings of the previous researchers. This helps to clearly identify the gap and therefore justify the need of doing the study on the impact of working capital management on SMEs profitability in Tanzania.

2.1 CONCEPTUAL REVIEWS

Concept of SMEs: According to the ministry of industry and trade in Tanzania, small businesses are collectively defined under nomenclature SMEs. SME is used to mean micro, small and medium enterprises. It is sometimes referred to as micro, small and medium enterprises (MSMEs). In Tanzanian context micro enterprises are those engaging up to four people in most cases family members or with an investment not exceeding 5 million TSHs, the majority of which fall under the informal sector. Small enterprises are mostly formalized undertakings engaging 5 to 49 employees or with capital investment of TSHs 5 million to TSHs 200 million. Medium enterprises employ about 50 to 99 employees and capital investment from about 200 to 800 million TSHs (Tanzania SMEs policy 2002). This definition was used in this work keeping in mind that the population of interest was Tanzania SMEs.

Inventory management: is primarily about specifying the shape and percentage of stocked goods. It is required at different locations within a facility or within many locations of a supply network to proceed the regular and planned course of production,trading and stock of materials.

Inventory conversion period: is the average amount of time that a business holds its inventory (Shin and Soenen 1998). It is the time required to obtain materials for a product, manufacture it and sell it. The inventory conversion period is essentially the time period during which a business must invest cash while it converts materials into a sale.

2.2 EMPIRICAL LITERATURE REVIEW

Management of inventory conversion period (ICP) was found to have a significant impact on profitability in studies from different countries.

Raheman and Nasr (2007) studied the effects of inventory turnover in days and current ratio on the net operating profitability of Pakistani firms. They selected a sample of 94 Pakistani firms listed on Karachi Stock Exchange for a period of six years from 1999 – 2004 and found a strong negative relationship between ICP and profitability of the firms. They found that as the ICP increases, it leads to decreasing profitability of the firm and managers can create a positive value for the shareholders by reducing the ICP to a minimum point.

Deloof (2003) studied the relationship between inventory conversion period (ICP) and corporate profitability. He used a sample of 1,009 large Belgian non financial firms for a period of 1992 – 1996. by using correlation and regression tests, he found significant negative relationship between gross operating income and inventory turnover days of Belgian firms. Based on the study results, he suggested that managers can increase corporate profitability by reducing the inventory turnover days.

Garcia – Teruel and Martinez – Solano (2007) collected a panel of 8,872 small to medium sized enterprises (SMEs) from Spain covering a period 1996 – 2002. they tested the effect of inventory conversion period (ICP) on SMEs profitability using the panel data methodology. The results which were robust to the presence of endogeneity, demonstrated that managers could create value by reducing their inventories.

Falope and Ajilore (2009) used a sample of 50 Nigerian quoted non financial firms for the period 1996 – 2005. Their study utilized panel data econometrics in a pooled regression, where time series and cross sectional observations were combined and estimated. They found a significant negative relationship between net operating profit and the inventory turnover in days for a sample of fifty Nigerian firms listed on the Nigerian Stock Exchange. The studies on the impact of inventory management on the profitability are almost peripheral.

3.0 OBJECTIVES OF THE STUDY

The purpose of this study is to provide an econometric impact of inventory conversion period on gross operating profits of SMEs in Tanzania.

4.0 METHODOLOGY

In this section, the sample size and data source, Key research variables, variable measurements, estimation techniques used for this study are presented.

4.1 SAMPLE SIZE AND DATA SOURCE

The study sample included twenty six (26) SMEs from two prime regions of Tanzania. It includes 10 SMEs from Morogoro region and 16 SMEs from Dar es Salaam region. Data was obtained from the financial statements of the selected SMEs for a period of five years from 31st March 2006 to March 2011. Apart from annual reports, required relevant data is sourced from websites.

4.2 KEY RESEARCH VARIABLES

The key variables used in identifying the impact of inventory management on profitability of SMEs of Tanzania include Inventory conversion period, gross operating profit, current ratio, firm size and financial debt ratio. The independent variable is Inventory conversion period and dependent variable is gross operating profit. The remaining are control variables. The type, expected coefficient sign and rationale or relationship between dependent and independent and control variables are shown in the following table followed by explanation of relationships.

TABLE 4.1: KEY VARIABLES AND THE EXPECTED IMPACT ON GROSS OPERATING PROFIT (GOP)

Variable	Type	Expected coefficient sign	Rationale
Inventory conversion period (ICP)	Independent variable	Negative	ICP↑⇒GOP↓
The current ratio (CR)	Control variable	Positive	CR ↑⇒ GOP ↑
Firm size (FS)	Control variable	Positive	FS ↑⇒ GOP ↑
Financial Debt Ratio (FDR)	Control variable	Positive	FDR↑⇒GOP ↑

INDEPENDENT VARIABLE

An independent variable is the variable which the researcher has control over, what he/she can choose and manipulate. It is usually what the researcher think will affect the dependent variable. In some cases, the researcher may not be able to manipulate the independent variable. It may be something that is already there and is fixed, something he/she would like to evaluate with respect to how it affects something else, the dependent variable. In this study the independent variable is the Inventory conversion period (ICP)

DEPENDENT VARIABLE

A dependent variable is what the researcher measures in the experiment and what is affected during the experiment. The dependent variable responds to the independent variable. It is dependent because it "depends" on the variations in independent variable. In this study the gross operating profit ratio (GOP) is used as the measure of Profitability of the firm and therefore it is the dependent variable in the study. The reason for using this variable is because the study aimed to associate the company's operating 'success' or 'failure' with an operating ratio and relate this variable with other operating variables .

CONTROL VARIABLES

A control variable is the variable that is held constant in order to assess or clarify the relationship between two variables. A control variable is not the independent variable in an experiment but it may affect the outcome of an experiment. It refers to the variable that is fixed or eliminated in order clearly identify the relationship between an independent variable and a dependent variable. In this study the following variables were controlled in order to come up with valid data.

The current ratio (CR) is a financial ratio that measures whether or not a firm has enough resources to pay its debts over the accounting period. It compares a firm's current assets to its current liabilities. If current liabilities exceed current assets (the current ratio is below 1), then the company may have problems meeting its short term obligations. If the current ratio is too high, then the company may not be efficiently using its current assets or its short term financing facilities. This may also have impact on firm's profitability, and therefore it must be controlled to avoid it from impairing the study. Financial debt ratio (FDR) is a financial ratio that indicates the percentage of a company's assets that are provided via debt (Deloof, 2003). Firm size in this study referred to amount of sales of the firm, and it was represented by the natural logarithm of sales.

4.3 VARIABLE MEASUREMENTS

The following below are the measures pertaining Inventory management and SMEs profitability:

No. of Days Inventory = (average Inventory/Cost of Goods Sold) x 365

Firm Size = Natural Logarithm of Sales

Financial Debt Ratio = (Short-Term Loans + Long-Term Loans)/Total Assets)

Current Ratio = Current Assets/Current liabilities

GOP = (Sales - Cost of Goods Sold) / (Total Assets - Financial Assets)

4.4 ESTIMATION TECHNIQUE (REGRESSION ANALYSIS)

Regression model is used to predict one variable (dependent variable) from one or more other variables (independent variables). In this part the researcher presented the empirical findings on the relationship between Inventory conversion period and profitability of the Tanzanian SMEs. To investigate the impact of Inventory conversion period on profitability, the model used for the regressions analysis is expressed generally as

GOP = ƒ (ICP, CR, FS, FDR,)

In the above general equation the GOP is the dependent variable and it is influenced by the independent variables i.e. ICP, CR, FS and FDR.

REGRESSION MODEL

ICP – Inventory conversion period influences the GOP in a negative way i.e. as the number of days increases, the GOP decreases and the vice versa is true. In this model the coefficient was negative (-ve)

$GOP = \alpha_0 + \alpha_1 CR_{it} + \alpha_2 FS_{it} + \alpha_3 FDR_{it} + \alpha_4 ICP_{it}$

Where

$\alpha_0, \alpha_1, \alpha_2, \alpha_3, \alpha_4, \alpha_5$ and α_6 are regression parameters which stand for the coefficients of the independent variables

CR is the current ratio

FS is the firm size

FDR is the financial debt ratio

The subscript "i" denotes number of observations and the subscript "t" denotes the number of years i.e. 5 years.

5.0 PRESENTATION OF FINDINGS

The variables were calculated using balance sheet (book) values. The book value was used because the firms did not provide any market value related to the variables that were used in this study. In addition, the measurement of profitability could only be based on income statement values, not on so called market values. The explanatory variables are all firm specific quantities and there is no way to measure these variables in terms of their market value. And also when market values are considered in such studies, the knowledge of the date for which the market value refers becomes unsolvable challenge. This is rather subjective; hence book values were put into the use. The findings are enumerated from two points of view a) descriptive analysis in terms of mean, standard deviation and correlations and b) applying multiple regressions (OLS).

5.1 DESCRIPTIVE ANALYSIS

Descriptive analysis shows the mean and standard deviation of the different variables of interest in the study. It also presents the minimum and maximum values of the variables that help in getting a picture about the maximum and minimum values a variable can achieve.

TABLE 5.1: DESCRIPTIVE STATISTICS OF VARIABLES (2006-2011)

	N	Range	Minimum	Maximum	Mean	Std. Deviation	Variance
GOP	26	1.38	0.07	1.45	0.7023	0.33082	0.109
ICP	26	334.62	2.67	337.29	134.6273	88.32051	7800.513
CR	26	16.81	0.06	16.87	3.9635	5.17067	26.736
FDR	26	2.14	0.00	2.14	0.6846	0.52827	0.279
SIZE	26	6.09	15.97	22.06	19.1658	1.54921	2.400

Source: *compiled from the information of annual reports run on SPSS*

The following observations can be made from the table which was prepared on the basis five year data from 2006-2011 for 26 SMEs.

- The GOP of 26 SMEs ranges between 0.07 and 1.45 with mean of 0.7023 and standard deviation of 0.33082 indicating high variance.
- ICP ranges between 2.67 and 337.29 days with an average of 134.6273 and standard deviation of 88.32501 signifying very high variability across 26 SMEs.
- The CR ranges between 0.06 and 16.87 with an average of 3.9635 and standard deviation of 5.17067 showing very higher variability in short term obligations repayment ability.
- The FDR ranges between nil and 2.14 with an average of 0.6846 and standard deviation of 0.52827. it signifies high variance in the financing pattern of the studied SMEs.
- The average size of SMEs recorded the logarithm of sales at 19.17 with a range of 15.97 and 22.06 , standard deviation of 1.5492. it also shows significant variance but not like other variables.

The above analysis concludes that all the 26 SMEs, though size wise comparatively not with high variance, the other selected variables are varying significantly as their standard deviations, ranges are significantly higher. The high variance is normally related with managerial decisions and efficiency in execution of their policies.

5.2 CORRELATION BETWEEN VARIABLES

An attempt is made here to find the relationship between ICP and GOP used in the model given in the methodology so as to know the direction of the impact of ICP on the profitability of the SMEs. For the purpose, Pearson's Coefficient of correlation analysis is applied to find the relationship between the inventory conversion period and gross operating profit (SMEs' profitability). As stated in review of literature, if inventory conversion period comparatively decreases over a period of time it enables higher turnover in sales and increase in GOP. Hence the expected relationship should be negative. In addition the relationship between GOP and control variables as well as ICP and control variables is also calculated. This is because change in ICP impacts control variables like CR.FDR.SIZE. The calculated relationship between these two variables along with control variables is presented in the following table.

TABLE 5.2: CORRELATION BETWEEN ICP, CONTROL VARIABLES AND GOP

	GOP	CR	FDR	SIZE	ICP
GOP	1.000	-0.304	0.418	-0.125	-0.464
CR		1.000	-0.498	0.000	0.281
FDR			1.000	-0.104	-0.188
SIZE				1.000	-0.174
ICP					1.000

Source: *compiled from the information of annual reports and run on SPSS*

From the analysis of the above table the following observations can be made:

1. The correlation between ICP and GOP is -0.464. It shows that decrease in ICP is resulting into increase in GOP and vice versa. This is as per the expected relationship.

2. The correlation between ICP and CR is 0.281, indicating decrease in ICP is resulting into decrease in CR and vice versa. This is as per the expected relationship.
3. The correlation between ICP and FDR is -0.188.it signifies that when ICP decreases, the FDR increases and vice versa. This is unexpected relationship, but it might be implying that the managers have failed to use effectively the resources generated due to decreased ICP in reducing debts.
4. The correlation between ICP and SIZE is -0.174, which indicates that decrease in ICP is resulting into increase in SIZE and vice versa. This is as per the expected relationship.

5.3 MULTIPLE REGRESSIONS ANALYSIS

In this section, the empirical findings on the relationship between inventory conversion period and profitability of the Tanzanian SMEs were presented. As the other reviewed researchers' findings stated, if inventory conversion period comparatively decreases over a period of time the GOP would increase. Therefore the expected relationship should be negative. The relationship between GOP and control variables as well as ICP and control variables was calculated using multiple regressions. The calculated relationship between these two variables along with control variables is presented in the following table.

TABLE 5.3: OLS REGRESSION ESTIMATES ON IMPACT OF ICP ON GOP

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	1.480	0.782		1.894	0.072		
CR	0.002	0.013	-0.032	-0.154	0.879	0.715	1.398
FDR	0.191	0.128	0.304	1.492	0.151	0.736	1.358
SIZE	-0.04	0.038	-0.167	-0.932	0.362	0.950	1.053
ICP	-0.002	0.001	-0.427	-2.293	0.032	0.885	1.130

Source: *compiled from the information of annual reports and run by SPSS*

The following observations can be made from the table:
1. The coefficient of ICP was negative (= -0.002). This implied that when the ICP decreases by 1 day then the profitability increases by 0.2%
2. The regression coefficient of CR was 0.002, which implies that an increase in CR by 1 is associated with an increase in profitability by 0.2% and vice versa. However the influence of CR on GOP (profitability) is low
3. The coefficient of FDR in the regression was 0.191 which implies that an increase in FDR by 1 is associated with an increase in profitability by 19.1%. In other way round, when the FDR decreases by 1 then the profitability decreases by 19.1%
4. The regression coefficient of SIZE was -0.04, which implies that an increase in SIZE by 1 is associated with a decrease in profitability by 4% and vice versa. However this is unexpected relationship which may be due to the inefficiency of SMEs resources management.
5. The VIF ranged from 1.053 to 1.398, starting from SIZE = 1.053, ICP = 1.130, CR = 1.358 to FDR = 1.398. This implied that each variable had some correlations with other independent variables. The tolerance range from 0.715 to 0.950, where CR = 0.715, FDR = 0.736, ICP = 0.885 and SIZE = 0.950. This implies that there was no problem of Multicollinearity. It should be kept in mind that Multicollinearity problem is observed when the tolerance is less than 0.1
6. The regression equation is:

GOP = 1.480 - 0.04LnS + 0.191 FDR + 0.002CR– 0.002 ICP

In this multiple regressions other tests were used; the R square test (R^2) and the F-test. The R^2 found to be = 0.356, which implies that the impact of ICP and the control variables included in the model was only 35.6%, the rest 64.4% of the impact on GOP was due to other factors out of the model

The t – test statistic was 2.903 which indicate that the linear relationship between ICP and GOP in the regression model exists as it falls under rejection area. The t statistics of between control variables and GOP is in rejection region.

6.0 CONCLUSIONS AND SUGGESTIONS

Previous researches predicted negative relationship between ICP and SMEs profitability. The results of this research are in line with the previous findings. The findings indicate that Inventory conversion period has an inverse relationship with SMEs profitability i.e. when the ICP days increase the profitability of firms decreases and vice versa. These results complied with those from studies by Raheman and Nasr (2007), Deloof (2003), Garcia-Teruel and Martinez-Solano (2007) and Falope and Ajilore (2009) who found negative relationship between ICP and profitability of firms. The relationship in this study is significant because for every one day decrease of ICP the increase in profit was 0.02 percent.

Finally the firm size, current ratio and financial debt ratio are the variables which appear in the regression model as control variables. In the regression model it was found that, the firms' profitability as measured by GOP has a positive relationship with financial debt ratio. This implied that profitability increases with increase in financial debt ratio. Furthermore in this study the relationship between the firm size and GOP was negative which was deviating from the expected relationship. The relationship between current ratio and the GOP was positive.

These results motivate the SMEs in reducing the present ICP of more than 4 months to enable them to improve their profitability. Consequently it effects control ratios and causes further impact on profitability. The decrease in ICP increases CR and liquidity position consequently positively affects FDR by liquidating the debts finally contributing to increase in profits. Similarly the efficiency in managing the above variables helps in increasing the size and also profitability of the SMEs.

SUGGESTIONS FOR IMPROVEMENT

The lack of knowledge in financial management is the persistent problem facing owner managers of SMEs, which was endorsed by many studies, is yet to be addressed by the government. On the other hand, owner managers must ensure that they utilise adequate inventory management tools like turnover ratios and ICP. The variance in ICP indicate higher varibiality in locking up of resources inp in Inventories, consequently resulting into variability in suppliers and other related commitments. Proper financial management education and training facility initiated by government and financing bodies may help them to address the problem of inventory management. The managements should concentrate on reducing the present ICP of more than 4 months so as to improve the financial performance.

7.0 SCOPE FOR FURTHER RESEARCH

Since this study is confined for only one variable of the working capital; ICP and its impact on profitability, it may be extended to all the variables of working capital and profitability of SMEs covering sample from all the regions of Tanzania. Future research may be extended to investigate generalization of the findings of all regions of the Tanzanian SMEs and also beyond Tanzanian SMEs covering entire Africa. The scope of further research may be extended to other working capital components including receivables, marketable securities and Cash conversion cycle management and to the different sectors such as Manufacturing, trading, service and agriculture. Further more the scope should be extended to industries like food processing, milling, poultry and even farming just to mention some of them

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