The Relationship Between Working Capital Management and Risk Management Among SMEs in the Philippines

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Working Capital Management WCM as a business strategy enables an organization to operate seamlessly and with minimal problems by monitoring its liabilities with its assets. Part of WCM is Risk Management, but often is an overlooked component specially for Small to Medium enterprises where priorities mostly focus on making profits. Risk Management RM on the other hand is quintessential for controlling present and future threats, allowing room to adapt due to uncertainties such as errors, accidents, and natural disasters. Organizations that have RM tend to focus more on customer service than profits particularly in COVID-19.

Keywords: WCM, RM, Working Capital Management Ratio, Negative Working Capital Ratio, Positive Working Capital Ratio, SMEs

INTRODUCTION

Working Capital Management WCM is a strategy framed and adopted by business managers for the goal of monitoring working capital. Means of working assets and current liabilities of a business that it calculates both to determine the financial and operational health. A metric called a Working Capital Ratio is determined that allows a business to see how it performs currently (Raheman, & Nasr, 2007). When this is done, the metric then allows decision making in dealing with free credit period offered to account receivables, monitors effective implementation of future credit policies and allows the business to keep optimum stocks and cash levels. It also allows the speeding up of the working capital cycle that eases liquidity position. Having a positive WC ratio means that the company has more funds to invest in future activities and growth not only for the short term (1-3 months) but also for the long term. On the other hand, having a negative ratio means there is a deficit in funds for future investment (Raheman, & Nasr, 2007).

Hence having WCM and determining its ratio for a company has its benefits, particularly in the underrated aspect of evasion of operation interruption (Nazir, & Afza, 2009). Newer companies having access to many financial management tools are subscribed higher to WCM learning from startups and businesses that can move in a practical manner (Nazir, & Afza, 2009).

Since WCM is involved in the use of ratio analysis, ratios on quick ratio, accounts receivable turnover, etc. these are calculated to interpret information for managers in planning and executing business operations most effectively. So much so that most WCM practices in the dimension of evasion of operations interruption also add elements of Risk Management to ensure the business can pay account receivables in time even in the face of adversities and calamities (Aven, 2016). risk management is another field of study, but it has intertwining elements found in WCM and evasion of operation interruption.

Having risk management is very essential for a corporation that can afford so since companies that can operate with forecasts can work seamlessly, make better tactical judgments not only in times of thriving but also in times of turmoil, the notion of flexible companies rather than mountain solid is setting new standards to post 2007 and 2009 world financial crisis (Aven, 2016). older companies have risk management features since most learn by assimilation, there is an internal and external risk such as political issues, exchange rates, interest rates, and so on. Internal risks, on the other hand, include non-compliance or information breaches. The challenge now is integrating Risk management practices with newer companies directly, or indirectly as part of WCM.

The study of Rostamie and Mansoori (2015) looked at 104 companies during 2010-2015 tested the hypothesis to look at RM as the Independent Variable (IV) and WCM as the Dependent Variable *DV) by using an ANOVA of a multitude of factors shows that there is a significant inverse relationship between the two variable. This means that managers may increase the level of investment in WC to decrease levels of risk associated. More resources are placed on WCM to address the risk that affects operations (day to day) but is not reflective at a strategic level. the researchers also pointed out that working capital and liquid working capital is affected by reactive risk management. in the events of a sudden risk, there is lesser working capital (Mansoori 2015)

The following study illustrates such a relationship between WC and RM among big corporations, but may not be the case for SMEs or small to medium enterprises that may be willing to spend more on WC and manage it, but may intentionally forgo spending on RM. But then again there are intertwining elements of WCM and RM. An unexplored facet with limited literature from Sharma (2011) and Gorondutse (2017) The situation in the Philippines may be different due to different business management principles that encompass both WCM and RM, hence this creates the need to test the hypothesis to explore:

Hypothesis

H0: *There is no relationship between WCM and RM among SMEs in the Philippine setting.*

H1: *There is a significant relationship between WCM and RM among SMEs in the Philippine setting.*

Rationale

Establishing a relationship between WCM and RM has been done inversely and with Larger companies, globally and the closest one with being with Southeast Asia (Gorondutse, 2017) The same had been done with SMEs but with more western countries such as the UK (Solano, 2007) which may have different business philosophies (e.g. start quick, fail fast, learn more) as compared to more conservative SMEs in Asian setting as Hofstede's cultural dimensions would suggest. Doing the same study with SMEs in the Philippines has not yet been done, the closest one would be with Dato-on, (2014) where the author explored the same relationship with corporations working in Cebu, but not with SMEs.

SMEs despite their size, are the budding business that would soon turn into corporations. Start-ups with great ideas are usually formed SMEs and those start-ups are the ones that introduce new paradigms when it comes to services particularly with the inclusion of online space. It is quintessential to know their WCM and RM ratios to create future guidelines on how to parley, strategically distribute working capital on only on the immediate gains, but also for weatherproofing their operations.

This research comes to an urgency, as of this writing, the world is faced with COVID-19, putting all non-essential business big or small, into lockdown. Those that have chosen online means to be their platform may not be facing much impact as compared to those onsite. But what this research will do is to illustrate the necessity to include RM and other means to deliver skeletal services in many creative platforms. Sufficed to say that those SMEs ahead of the curve and spent resources on back-ups are cushioned, this research aims to test that notion as well.

Scope and Limitations

The study at hand would focus primarily on the knowledge gap presented, SMEs in the Philippines particularly those in the service industry where there may be little or no inventory

REVIEW OF RELATED LITERATURE

Working Capital Management Meta-analysis

A meta-analysis of Singh, Kumar & Colombage, (2017) studied WCM in almost 1000 MNCs from the period of 1990 to 2010, in their analysis, the collective definition of WCM formulated as a "Strategy framed and adopted by strategic business managers implemented with a top to bottom approach, then applied and monitored by operational managers to ensure that working capital (current assets and liabilities) are balanced well. Calculated in a way that a ratio of financial and operational health is created. A metric is seen as a forward performance of a business.

In the same study, the researchers enumerate the advantages of WCM that ensure liquidity, enhances profitability, improves on financial health, add value, and evades operational interruptions and risks (more on this further). The disadvantages according to the researches are that it only focused on monetary factors, based on data, and if the company is not aligned with what the data means (especially for multidepartment) then there will be a problem in interpretation (Singh, Kumar & Colombage, 2017) one recurring issue with WCM is that even though it factors in risk, some risk is not situational and focuses mainly on losing profitability e.g. the possibility of a recession, and a global pandemic.

WCM Among Western SMEs

The caveat of the meta-analysis is that it was mainly focused on large companies, mostly western, and without consideration for eastern, and SMEs. The study of Garcia-Terual and Martinez-Solano (2007) fortunately looks at the effects of WCM on SME profitability and Risk levels (not management). Working with a panel of 8,872 SMEs in Europe from 2006 to 2002, their findings indicate that managers that can utilize WCM properly have more value to give to operations and process, using reducing inventories, reducing the number of days which their accounts are left outstanding, moreover, shortening the cash conversion cycles to improve profitability further reducing the risk gap of said companies.

WCM Among Asian Corporations

Again, the literature gap when it comes to Asian SMEs is huge, since most are focused on a larger organization that can create their own WCM and RM departments. The study of Gorondutse, Abass, Abubakar, and Naala (2018), and Sharma, A. K., & Kumar, S. (2011) both examines the effects of WCM, factoring in the size of the firm, sales growth, leverages among 66 companies from 2006-2012. The results show a positive rate when it comes to stock turnover days, account receivable days, cash conversion cycles, ROE, ROA, Net Operating Profit on Cash Conversion Cycles, yet having a negative effect on Net operating profit (Gorondunste, 2018).

The two studies imply that "corporations' managers to better manage their working capital because of the better the management of their working capital the lower the need for borrowings. If corporations choose to take a long period to pay their suppliers, it must be done in a way relation its future effects are considered. Lenders, on the other hand, are a viable option, provided that the corporation can pay on time, reduce the acute risk and that can happen in the future. Therefore, working capital policies should be aimed at giving the right balance of making a profit versus accumulating debts. Increasing internal control for credit risk has been one of the features of WCM and the two studies reflect that with Asian corporations

On the other hand, SMEs can take a long period to pay their suppliers as far as that will not harm their relationship with the suppliers. Moreover, stakeholders such as lenders can also benefit from this study by considering SME's working capital policies to understand the going concern of SME's profitability in the future to strengthen their internal control for credit risk of SMEs and to decide whether they continue to give credit to the SMEs.

WCM in the Philippines: A Localized Study in Cebu

Since the study at hand would focus geographically on the Philippines, there is a study conducted by Aldaba (2018) that explores how WCM is utilized with SMEs in the Philippines. In his study, he aims to assess the necessity of WCM as the author believes it is underutilized among this demographic group. the author believes that SMEs focus primarily on making their bank receipts and bank account position made on due time. But in most of his findings of SMEs in Cebu lack an understanding of standard credit policy, least concern for WCM when it comes to risk management beyond a month or more. But what the study coincides with other SMEs on a western front such as Garcia-Teruel (2007) was that "various components in working capital management like cash flow and accounts receivable management, accounts payable and inventory management greatly affect the liquidity and profitability of SMEs".

This understanding of SMEs in Cebu about WCM allowed the author to see that most struggle to survive their industry due to the lack of implementing a customary credit policy with suppliers and lenders. There must be better internal control and financial system as reflected by bigger corporations shown by Goronduntse (2018). Not only that, but there must also be an emphasis on including risk management practices as part of WCM for any PESTLE factors (such as plague in the case of this writing). These risks are universal and inevitable. Regardless of size and location, business quintessential must factor in Risk management in their WCM.

Risk Management

Risk management defined as of this writing is the process of assessing and identifying threats to an organization's capability to perform operations and even follow through on visions and missions. Rudimentary tasks are usually those collecting data and data related risks. Then formulating a strategy to alleviate them before they can become problems. a proactive approach rather than a reactive one, and being proactive means factoring in external influences such as PEST, political, economic, social, technological, not to mention legal and Environmental that would account for pandemics and global legal shifts (Giannakis, & Papadopoulos, 2016).

having a proactive risk management approach means investing in tools and techniques, funds that would come from an allocated source or even from Working capital. with proactive approaches based on previous performance, forecasting, and integration of new policies, technologies, and practices. This is mainly complemented with investment and capital decisions, since its not always the case of a win-win situation. RM analyses potential risks that may pose itself if certain conditions are met. So, to minimize the effect, the conditions, or the exposure, RM is done not only internally but also externally looking at a recession, high inflation, volatility in capital markets, and natural disasters (Giannakis, & Papadopoulos, 2016).

Provided that most RM tools and techniques are integrated, it must mean that they come from capital, buying these would then mean allocating funds and putting them in some priority. Internally SMEs do RM to meet financial obligations and financial daily operations. Larger companies have the luxury to be far-sighted and even future proof of their operations and platforms to reduce risks.

Connecting Both Variables

These are done by correlating metrics for WCM such as the Working capital ratio, and metrics for RM such as *AON Risk Management Survey* (done post-incident). in most of the studies provided under this Review of related literature, this was done to depict a linear relationship between the two, a positive WC ratio means that the company can fund future activities for growth, ideally illustrating optimized use of funds. Whereas a negative WC ratio means there are too many liabilities that are needed to be paid. But as the study of Mansoori, D. E., & Rostami, R. (2017) shows, it's not always the case that a negative WC ratio is a dire situation, it may mean that the company has a principle to always allow the money to flow towards a project of improvement, a proactive approach. Bigger companies have the luxury to do so, in comparison Martinez-Solano (2007) shows that SMEs are more comfortable to have a positive WC ratio to ensure there is money needed for more reactive response to the crisis

Theoretical Framework

Working Capital Ratio $\rightarrow$ Risk Management Score

Provided that a significant relationship exists ($p < 0.05$) among SMEs in the Philippines:

Negative Working Capital Ratio $\rightarrow$ Risk Management Score

A proactive approach to risk management may exist among the participants reflective of western companies (spend more to mitigate future risk and decrease delay)

Positive Working Capital Ratio $\rightarrow$ Risk Management Score

The reactive approach means keeping a level of money to respond to any incoming risk or delay reflective of SMEs in the Southeast Asian setting.

METHOD

Participants

SMEs recruited for this study are those that belong in *BNI Iconic Philippines*, a network of Small Business Owners usually startups that meet periodically at Enderun College Taguig, more than 100 businesses that network their services and goods to each other. Following a strict policy of non-saturation of services and goods, leads generation through referrals. Most of these organizations have BSC integrated within their business before joining the organization.

Design

The study will utilize a *Regression analysis* with *Moderating Variables*. Where the IV is WC Ratio Calculated and the DV is Risk Management Scores. Determining the relationship of the IV and the DV will be done with regression analysis where $p < 0.05$ illustrates the causal relationship.

Tools and Metrics

The working capital ratio is calculated simply by dividing total current assets by total current liabilities. For that reason, it can also be called the current ratio. In general, the higher the ratio, the greater the flexibility of an organization to expand operations and to invest. If the ratio is decreasing, the company may be spending more on long term investments or simply dwindling on performance (that a manager should know) (Kookda, 2019).

Computing for Risk Management scores will be done with AON Risk Management Survey, published in 2017, this survey is provided to organizations to assess disruptive innovation/ innovation, cybercrime instances, operational blunder, political

Statistical Analysis

The way both IV and DV data would be analyzed will be with Microsoft Excel onboard statistical analysis tool

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