

AN EXPLORATORY STUDY ON WORKING CAPITAL MANAGEMENT AMONG PETTY TRADERS IN KUALA NERANG, KEDAH

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ABSTRACT

Petty trading is a common economic activity amongst locals in Kuala Nerang, Kedah. Currently, an ironic situation exists where the petty traders in Kuala Nerang claim that their businesses are profitable yet they still face a deficiency in working capital. To explore the situation, this working paper aims to identify the reasons behind the high instances of working capital deficiency amongst the petty traders. To this end, the following research questions are raised. Why does this problem occur? Do the petty traders actually suffer a loss in their businesses? Do they keep their accounting records properly to enable them to ascertain whether their businesses generated a profit or suffered a loss? The findings reported in this paper are based on in-depth interviews drawn from a convenience sample of 20 petty traders in Kuala Nerang. It was revealed that accounting records are not kept in order, and therefore, the profits made cannot be determined accurately. This could be due to a lack of understanding on working capital management among the petty traders. Hence, it is not unusual for them to encounter a shortage in working capital.

KEYWORDS: *petty traders, working capital, accounting records, rural informal sector, Kuala Nerang*

1.0 INTRODUCTION

The discovery of an unorganized, unregulated and mostly legal but unregistered informal sector was first recognized in the early 1970s (Todaro & Smith, 2003). This sector continues to play an important role in developing countries around the world including Malaysia. The informal sector is characterized by a large number of small-scale production and service activities that are individually or family owned that use simple technology and small profit for self-used only. Different types of activities are engaged ranging from hawking, street vending, barbers, mechanics, carpenters and personal servants. Becker (2004) has classified the informal sector as low entry requirements in terms of capital and professional qualifications, a small scale of operations, skills often acquired outside formal education and labour-intensive methods of production and adapted technology. In addition, Todaro and Smith (2003) characterized the self-employed workers in this sector as having little formal education, lack of skills and lack of access to financial capital. As a result, productivity and income in this sector is lower than in the formal sector. The workers also do not enjoy the protection accorded by the formal sector in terms of job security and old-age pensions. They will face problems if their businesses suffer from losses as they do not have any financial backing to buffer them.

In terms of its relationship with other sectors, the informal sector is closely related to the rural sector as it allows excess labour to escape from rural poverty. The formal sector depends on the informal sector for cheap inputs and goods for its workers while the informal sector depends on the growth of the formal sector for a good portion of its income and clientele (Todaro & Smith, 2003). Hence, the informal economy's growth or decline has essentially been linked to the growth of the formal sector. Becker (2004) stated that in some countries in Asia, this sector has in effect declined during the economic boom and increased during the economic recession. Statistics from the International Labour Organization (2002) stated that the informal sector covers 70% of the economy in Sub-Saharan Africa, 62% in North Africa, 60% in Latin America and 59% in Asia. To summarize, this sector is continuously increasing in most developing countries, even in rural areas. It has become clear that the informal sector has a significant job and income generation potential. However, employees in this sector do not receive enough recognition for their contribution in developing countries.

On a more positive score, informal sector activities are also found in developed countries with more promising outcomes to those engaged in them. For instance, informal activities are flourishing and getting

popular in developed nations like the United States. In America, scholars have shown that informal sector activities are viewed as viable and sustainable livelihood options to rural communities (Slack 2006; Ratner 2000). In the Malaysian context, signs of interest in rural informal sector, like in the case of Kelantan and Terengganu, are emerging albeit at a very gradual pace (Wan Ahmad, Rahman and Ismail 2011).

In the context of this study, the main challenge is to develop innovative and supportive policies that recognize the contributions of the informal sector like petty traders in Kuala Nerang towards economic growth in Malaysia. Petty trading is an informal and small scale economic activity that requires small capital and generates low income (Daily Observer, 2009). Generally, petty trading is a worldwide phenomenon that has successfully been adapted into the economic growth in many countries (Kamara, 2008). Similarly in this study, petty trading is a common and important economic activity amongst locals in Kuala Nerang - a district capital of Padang Terap district. The importance of petty trading in Kuala Nerang justifies why they were chosen as the subject of this study. Kuala Nerang is a small town located between Alor Star, Kedah and Durian Burung. Approximately 70% of the local population in Kuala Nerang are involved in petty trading. In fact, more than 400 petty traders are registered with The Malay Petty Traders Association of Kuala Nerang (*Persatuan Peniaga dan Penjaja Kecil Melayu Kedah Cawangan Kuala Nerang*). Common businesses in this area are nat market (morning market), night market, food stalls and sewing shops/boutiques. However, the fate of these traders rural Kuala Nerang is very different compared to petty traders in urban areas such as Pulau Pinang and Kuala Lumpur.

A research study from USM (2008) showed that the average income of petty traders in Pulau Pinang was RM 2100. The average income is more or less the same or higher in Kuala Lumpur given that these two urban areas provide greater business opportunities and broader market. In small towns like Kuala Nerang, the average income for petty traders is lower and inconsistent as the town provides less opportunity and limited market. They are more vulnerable than other businesses because their income is not consistent due to elements of 'uncertainty' in the nature of their business. The petty traders here in Kuala Nerang often suffer from financial deficit as a result of uncertain income which could lead to instability in their future.

A research report from USM (2008) apparently claimed that their businesses are profitable yet they encounter deficiency in working capital. The Domestic Trade, Cooperatives and Consumerism Ministry

(KPDNKK) conceded that petty traders in Malaysia frequently suffer from working capital deficiency in their businesses. The ministry is looking for an effective mechanism to upgrade the status of hawkers and petty traders in the country (Bernama, 2012). The objective of this paper is to identify the factors that lead to working capital deficiency among these petty traders in their respective businesses. The outcome of this study will widen our view on understanding the problems suffered by them. Subsequently, appropriate methods to overcome the difficulties will be recommended.

2.0 LITERATURE REVIEW

Working capital management (WCM) is one of the essential parts in business management decisions. Working capital refers to a business investments in short term assets-cash, account receivables and inventories (Ashraf, 2012). Working capital management refers to the application of investment and financing decisions to current assets. Good working capital management will generally increase a company's liquidity and profit (Reddy & Kameswari, 2004). Md. Sayaduzzaman (2006) defined working capital as "*amount of funds which a business needs to finance its day to day operations*". It is an investment needed for daily operations for businesses that should not exceed one year (Kesseven Padachi, 2006) which can be mathematically calculated as current assets minus current liabilities.

Working capital management is very crucial in business planning due to its direct impact on business's profitability and liquidity (Rehman & Nasr, 2007). Efficient working capital management must have good planning and controlling of current assets and current liabilities in a manner that eliminates the risk of inability due to short term obligations and to avoid excessive investment in these assets (Ashraf, 2012). Referring to the theory of risk and return, an investment with more risks will result in more returns. Thus, a business with high liquidity of working capital will supposedly have low risks and low profitability. Conversely, a business that has low liquidity of working capital may face high risk resulting in high profitability.

The purpose of WCM is to manage the business's current assets to obtain the much needed equilibrium between risk and profit (Umara Noreen et al., 2009). Although the main objective of doing business is to maximize profit, preserving liquidity of the business is also important. Increasing the profits at the cost of liquidity can bring serious problems to a business. Both profit and liquidity must be managed equally as

they are really important in business survival. Effective WCM will generally bring about a high level of profit and positive cash inflow for daily operations. Thus, the people will enjoy good facility of cash credit and working capital loans from commercial banks as a result of a satisfactory level of liquidity (Md. Sayaduzzaman, 2006).

In Kuala Nerang for instance, petty traders claim to obtain profit from daily operations but they are unable to determine the exact revenue and profit from the businesses. Perhaps this could be related to a lack of understanding in working capital management. Contrary to the definition of WCM which means proper working capital management will lead to profit and revenue, these petty traders are still able to gain profit from their businesses without proper working capital management. An assumption that can be made from this situation is that they do not keep accounting records for their businesses. Lack of accounting records will lead to uncertainty in terms of profit in their daily operations, thus, resulting in working capital deficiency. Petty traders are from the informal sector which does not need large amounts of working capital to run their daily businesses. However, working capital management is still essential to determine their revenue and profit from their businesses.

3.0 METHODOLOGY

This study was conducted in Kuala Nerang, Kedah with the assistance of The Malay Petty Traders Association of Kuala Nerang (*Persatuan Peniaga dan Penjaja Kecil Melayu Kedah Cawangan Kuala Nerang*). The association has 112 active registered petty traders scattered within the town of Kuala Nerang. Twenty (20) respondents were selected randomly from 112 active petty traders. They were divided into business categories. Five nat markets, twelve food and beverages stalls, two boutique and saloon shops and one newspaper stall.

A qualitative method in collecting data was used. In-depth interviews were conducted with 20 selected respondents based on a standard questionnaire. The questions focused on their personal particulars, businesses and their knowledge on accounting records and working capital management. Each in-depth interview took approximately an hour to finish per respondent and was conducted on Fridays over a course of two months. The respondents requested not to be interviewed during working days as this will disrupt their daily business. Data collected from the in-depth interview was analysed by content analysis.

4.0 RESULTS AND DISCUSSIONS

Based on the in-depth interview with 20 selected respondents, 4 (20%) were males while another 16 respondents were females (80%). The majority of respondents (70%) were aged 46 years and above while (30%) were aged between 35-45 years. All 20 respondents were engaged in trading as their full time occupation. Only four respondents (20%) were involved in another part-time occupation other than petty trading.

4.1 Proper Accounting Results in Better Working Capital Management

From the 20 respondents, 15 respondents (75%) claimed that they have problems in working capital while five of them (25%) agreed that they do not have any problems in working capital. These five respondents believed that they do not have difficulties in working capital because their profit is sufficient for them and they are able to generate extra income from their daily businesses. The factor that contributes to this is the proper accounting records carried out for their businesses. They believe proper accounting records will enable them to control the cash flow of the businesses. One respondent stated;

"I do not have any trouble in my business in terms of profit. One factor leading to it is keeping accounting records for reference. I can control the cash flows efficiently and easily."

Another respondent said;

"I have to deal with a lot of money in my business, so accounting records are the only way I can manage and control the cash flow efficiently."

There was also one respondent who claimed to have insufficient profit but still managed to keep proper accounting records in his business. This respondent proved that accounting records are really an important part in working capital management. The respondent claimed:

"I suffered from insufficient profit from my business but I know how to manage it wisely because I keep my accounting records so that I will not over-use the income I obtained."

Hence, these traders realized that accounting records will help them run their businesses efficiently and enable them to control the cash flow wisely. Good cash flow in accounting records will provide them with more revenue and profit. If they have good accounting records history, they will have fewer problems in applying for loans and financial

assistance as they have proof of their business cash flow. These five respondents could continue to grow and expand their businesses because of the effectiveness in working capital management. In other words, with good knowledge of working capital management (WCM) in terms of proper accounting records, petty traders will have less difficulty in managing their cash flow to gain more profit and enable them to expand their businesses which will lead to better income too.

4.2 Lack of Knowledge in Accounting Records Lead To Deficiency in WCM

However, the other 15 respondents claimed to have a deficiency in working capital despite gaining profits from their businesses. It is assumed that without proper accounting records, they cannot determine their revenue and profit, and this proves that they have a deficiency in working capital. One respondent reported:

"I do not keep any accounting records for my business because I do not have enough time to write down the records. I prefer to just remember the cash flow details."

A similar statement was echoed by another respondent:

"I do not need to spend a lot of money to run my business daily. That is why I think accounting records are not important to me."

The traders assume that accounting records are not important in managing their daily businesses. Accounting records are one of the essential parts in working capital management. Some of the respondents also agreed they do not have any knowledge of accounting records. One respondent confessed:

"I do not keep accounting records for my business because I do not know how to write down the cash flow in the book. It is easier to just remember the cash flow."

Cash flow is one of the important aspects in working capital management. Cash flow is a revenue or expense stream that changes a cash account over a given period. Without proper knowledge in cash flow, which is very crucial in managing daily businesses operations, petty traders will have difficulties to determine their status of cash, account receivable and account payable in their businesses. They also will have problems in terms of loans from banks and government agencies as they do not have any proof of accounting records from their businesses.

Apart from not keeping any accounting records, all of them claimed to acquire insufficient and uncertain profit from their businesses. According to one of them:

"I suffer from uncertainty in terms of profit from my business. I just depend on loans and assistance from banks and government agencies to support my business."

Another respondent also shared a similar remark:

"I always encounter uncertainty in terms of profit. The profit is there, but never enough for my family and I. Loans from banks and illegal loan sharks are the only way I can have money for my business."

From this statement, we can conclude that the traders can easily mix their business income with family expenditure. This problem occurs due to lack of accounting records among them. They do not realize that the accounting records enable them to manage the cash flow of their businesses and the extra income they obtain from daily operations can be used for family expenditure without interrupting business cash flows.

5.0 CONCLUSIONS

It is clear that the majority of the respondents (75%) do not understand the basic concept of working capital management. Most of them (75%) also indicated that they do not keep any accounting records for their businesses. They claimed that they gained profit but they did not know the exact amount of profit they obtained from daily operations of their businesses. The five respondents (25%) who maintained accounting records realised the importance of these records in running their daily operations. These records will indicate to them how much profit they have gained, how much loss they have suffered and how much income they have obtained from the businesses.

However, all of them understand the meaning of the term profit. They described profit as the revenue gained from the daily operations and the explicit cost of generating the revenue. To summarize, the factor that leads to deficiency in working capital among petty traders is lack of accounting records in their businesses as they did not realize the importance of accounting records in improving their businesses. Perhaps, low levels of education among these petty traders could be a contributing factor that shaped their knowledge level in working capital management.

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