FACTORS INFLUENCING CASH FLOW DEFICIENCY AMONG SMALL AND MEDIUM-SIZED ENTERPRISES IN MELAKA

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Master of Business Administration in Technology and Innovation Management

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FACTORS INFLUENCING CASH FLOW DEFICIENCY AMONG SMALL AND MEDIUM-SIZED ENTERPRISES IN MELAKA

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A thesis submitted in fulfilment of the requirements for the degree of Master of Business Administration in Technology and Innovation Management

Institute Of Technology Management
And Entrepreneurship

UNIVERSITI TEKNIKAL MALAYSIA MELAKA

2008
DEDICATION

To my husband Hassan bin Attan
&
my children; Nazhan, Nafiz, Nasir and Humaira
with love
ABSTRACT

The study is conducted to test hypotheses which are to examine whether or not the conjectured relationships have been substantiated and an answer to the research question has been obtained. It is to explain the nature of certain relationships in a situation. This study reports the findings on the factors influencing cash flow deficiency among SMEs in Melaka. The study focused its investigation on six independent variables which are poor bookkeeping, trade credit, slow paying customers, excessive stocks hold, weak credit control management and poor technologies and innovation to the dependent variable of cash flow deficiency. The efforts observed interviewed and distributed questionnaires throughout SMEs in Melaka. It also reviewed overseas and local literatures. Research design was drawn for requisite data to be gathered and analyzed to arrive at a solution. The research design, which involves a series of rational decision-making choices, is presented. Issues relating to decisions regarding the purpose of the study, the type it should conform to (type of investigation), the extent to which it is manipulated and controlled by the researcher (extent of research interference), its location (the study setting), measurement and measures, the level at which the data will be analyzed (unit of analysis), sampling design, its temporal aspects (time horizon), and data collection method are integral to research design. There were 52 samples out of 438 populations of registered SMEs in Melaka which indicates 12% of population; however most of them were micro SMEs and would be the basic focus of this study. The significant of the study is to realize policymakers, strategic planners, managers of SMEs and customers on the state of the importance of what actually matters that can help SMEs to survive and sustain in the market. Results from the analysis shown the significant of independent variables and proved the relationships have been substantiated to the dependent variable which contribute a great influence to cash flow deficiency among SMEs in Melaka. It was concluded from the study that 'poor' or 'careless' financial management (management of the said independent variables) had been identified as a major cause of small business failure. It can cause wrenching problems. Recommendations are business must plan for certain payments, such as payroll expenses, loan payments, payments to key suppliers, payment for assets and so on. Business need to incorporate these payments into cash flow forecasts and then make sure those sufficient funds will be available at those key times. They need to make sure that any purchases are scheduled when cash position is stronger or are structured over a longer time frame to reduce the impact on cash flow.
Kertas projek ini disediakan bagi tujuan mengenalpasti samaada terdapat atau tidak hubungan antara enam faktor-faktor bebas iaitu; penyimpanan rekod yang lemah, urusniaga secara hutang, pembayaran yang lambat dari pembekal, penyimpanan stok yang berlebihan, kawalan kredit yang lemah dan kurang teknologi dan inovasi terhadap faktor yang bergantung iaitu aliran tunai defisit bagi industri kecil dan sederhana (IKS) di Melaka. Ianya dilakukan dengan cara pemerhatian, menemuramah dan juga mengedarkan borang soal selidik kepada responden IKS yang berdaftar di seluruh Melaka. Ianya juga melibatkan pembacaan dari artikel-artikel tempatan dan juga luar negara. Rekabentuk penyelidikan telah dikenalpasti dan dilakar bagi menjalankan penyelidikan untuk tujuan mendapat hasil keputusan yang memuaskan. Ia melibatkan; tujuan menjalankan kajian, jenis kajian, sejauh mana kawalan penyelidik, tempat kajian, ukuran dan pengukuran, analisa unit, rekabentuk contoh, tempoh masa dan seterusnya cara pengumpulan data. Terdapat 52 contoh daripada 438 populasi IKS di Melaka iaitu contoh adalah sebanyak 12% dari populasi. Walau bagaimanapun, kebanyakan daripadanya adalah dari kategori mikro IKS yang menjadi tumpuan kepada kertas projek ini. Kepentingan kertas projek ini adalah untuk memberi kepekaan kepada penggubah polisi, perancang strategi, pengurus IKS dan juga pelanggan terhadap apakah yang sebenarnya diperlukan oleh IKS untuk maju dalam perniagaan dan seterusnya dapat bertahan dalam industri perniagaan ini. Keputusan dari kajian ini menunjukkan ianya mempunyai hubungan yang kuat antara faktor-faktor bebas dan faktor kebergantungan tadi dan dikenalpasti sebagai penyebab-penyebab utama masalah aliran tunai defisit. Cadangan daripada ini adalah IKS mesti membuat perancangan yang rapi untuk belanja iaitu dengan membuat perancangan aliran tunai dan sentiasa pastikan aliran tunai adalah cukup untuk tujuan perbelanjaan tersebut. Segala perolehan hendaklah dijadualkan secara rapi daripada awal dan untuk suatu tempoh yang panjang bagi tujuan mengurangkan kesan daripada ketidakstabilan aliran tunai.
Praise to Allah the Almighty for His kind forgiveness and love, from those who loved Him. The study is carried out as partial fulfilment of the requirements for the Degree of Master of Business Administration (MBA) at the Institute of Technology Management and Entrepreneurship, Universiti Teknikal Malaysia Melaka (UTeM). It is to get to know what are the problems facing by small and medium sized enterprises in Melaka in carrying out their business in the aspect of cash flow as well as to find the ways to solve the problems. It is a great chance to study and also great challenges that I have been facing. However, with the accomplishment of this, thank you for the love, support and happiness from my loving husband Hassan b. Attan, loving children Nazhan, Nafiz, Nasir and Humaira, which in turn given me the strength to finish what I have started and also not forget to my mother Hajjah Hasmah bt Hj Abd Rahman, my father Hj Abdul Aziz bin Hj Ibrahim, my sisters and brothers. I would also like to thank those who have helped and guide me along the way especially to my supervisor YBhg Dato’ Prof. Dr Abu Bakar bin Mohd Yusof, my lecturers, my colleagues at UTeM and the Universiti Teknikal Malaysia Melaka for aspired me to walk this challenging path of becoming a wife, a mother, an accountant and as an MBA student all at the same time. All I have done is aimed of becoming a good human being.
DECLARATION

I hereby declare that the project paper is based on my original work except for quotations and citations that have been duly acknowledged. I also declare it has not been previously or concurrently submitted for any other degree at UTeM or other institutions.

Signature : ..........................................
Name : NOR AZAH BINTI ABDUL AZIZ
Date : 29 February 2008
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CHAPTER 1

INTRODUCTION

1.1 Background of Study

Developing a group of diverse and competitive small and medium-sized enterprises (SMEs) is a central theme towards achieving sustainable economic growth. SMEs are crucial to the economic growth process and play an important role in the country's overall production network. Some advanced economies have succeeded because SMEs form a fundamental part of the economy, comprising over 98% of total establishments and contributing to over 65% of employment as well as over 50% of the gross domestic product. Although the numbers might be lower in Malaysia, SMEs have the potential to contribute substantially to the economy and can provide a strong foundation for the growth of new industries as well as strengthening existing ones, for Malaysia's future development. SMEs are the growth generators for economies worldwide, the frequent incubators of ideas and inventions and the basis of the Malaysia economy. Many of new jobs in Malaysia are generated through SMEs. Most businesses fall into this category. Therefore, governments (federal, state and local) are interested in helping to make them successful. Big business also is interested in SMEs because of the ideas and technology they generate. Many large businesses grow from the acquisition of smaller firms.
What is particularly important to SMEs? One of the most important matters to SMEs is the control or monitoring of cash flow. If SMEs do not know what cash flow is, then they can never run a business. There is no question in any small or medium business owner's mind that cash flow is the key to success. If they do not keep their eye on the cash -- not the financial statement, the cash (as in how much came in today and what amount went out today and this week and this month) -- then they would not be in business very long. Cash flow is the movement of money within a business, both income and expenditure, and is the key for business survival and growth. Poor cash flow management has in the past, and still does today; put an end to some of the more successful businesses. It therefore goes to show that no one or company or organization is safe from the dangers of suffering cash flow problems, particularly as some of them may be unforeseeable.

Previous studies shows that cash flow problems are responsible for causing over 70% of businesses to fail within their first year of operation (Dodge et al, 1994). Consequently, it is the main reason for business failure. Managing cash-flow and the cash conversion cycle, is a critical component of overall financial management for all firms and particularly small firms who are often more reliant on short-term sources of finance (Walker and Petty, 1978; Cosh and Hughes, 1994). Empirical studies of their respective financial structures have shown that, in comparison to large firms, small ones are less liquid, exhibit more volatile cash flows and profits, and rely more heavily on short term debt funding. Moreover, they are more likely to be credit rationed, with financial institutions restricting the flow of funds to sectors when they are unable to fully evaluate the risks involved (Walker and Petty, 1978; Cosh and Hughes, 1994).
Therefore, SMEs need to find out what are the critical factors influencing cash flow deficiency before their business collapse. Cash flow deficiency is an imbalance between cash inflow and outflow whereby cash outflow is greater than inflow.

1.2 Problem Statement

Based on the observation, preliminary data gathering through a few interviews with SMEs’ suppliers in Melaka and literature survey, SMEs are very hard to survive or operate at less or no profit because of cash flow problem. Cash flow is an important element to business whereby business needs cash to pay for marketing, to make payroll, to improve credit rating, to pay taxes, to take advantage of seasonal demand, to take advantage of vendor discounts, to grow and to expand business. Cash flow defects are amongst the most common internal causes of business failure, therefore, the study is going to find out what are the factors influencing cash flow deficiency to SMEs. Problem definition or problem statements to the study are:

1.2.1 To what extent does the poor bookkeeping contribute to defective cash flow?

1.2.2 How has trade credit affected cash flow?

1.2.3 Has the slow paying customers resulted in negative cash flow?

1.2.4 Do excessive stocks hold lead to cash flow problem?

1.2.5 Can cash flow influenced by credit control management?

1.2.6 How does technologies and innovation affected cash flow?
1.3 **Objective of Study**

The study is conducted to test hypotheses which are to examine whether or not the conjectured relationships have been substantiated and an answer to the research question has been obtained. It is to explain the nature of certain relationships in a situation.

1.4 **Hypotheses**

1.4.1 Poor bookkeeping will influence cash flow deficiency.

1.4.2 There is a relationship between trade credit and cash flow deficiency.

1.4.3 Slow paying customers will influence cash flow deficiency.

1.4.4 The greater stocks are hold, the more serious to cash flow deficiency.

1.4.5 The weaker the credit control, the more defect the cash flow.

1.4.6 Lack of technologies and innovations will influence cash flow deficiency.

1.5 **Scope of Study**

This study reports the findings on the factors influencing cash flow deficiency among SMEs in Melaka. The study focused its investigation on six independent variables which are poor bookkeeping, trade credit, slow paying customers, excessive stocks hold, weak credit control management and poor technologies and innovation to the dependent variable of cash flow deficiency. The efforts observed and distributed questionnaires throughout SMEs in Melaka. It also reviews overseas and local literatures. It is the mission of this study to inform policymakers, strategic planners, managers of SMEs and customers on the state of the importance of what actually matters that can help SMEs to survive and sustain in the market.
1.6 Significant of Study

It is often said that in business "Cash is King", this is said because cash is all important to businesses. Without cash employees cannot be paid, suppliers cannot be paid, and therefore the business will grind to a halt. Cash is the oil in the machine of business, and a Cash Flow Statement tells us the cash inflows and outflows in a business over a period of time. Why is Cash flow so very important? Many enterprises try to take good care of customers and employees but often fail to take good care of cash flow. In some organizations, the receivables run into more than 90 days. As a rule of the thumb, any receivable above 120 days can be classified as a doubtful debt. This problem is more in the case of SMEs and organizations that compete on low prices.

Thus, the study is very significant to the business. To society, this is the way to realize that the faster their pay to SMEs, the better the SMEs can survive. The theory of cash flow is relevant by knowing and analyzing the defective factors to cash flow. To Policy makers, the study is very relevant to make a better policy if accurate factors influencing cash flow deficiency can be identified.

1.7 Organization of The Project Paper

The organizations of this paper are as follows: the first section provides some background and a brief overview of related studies together with the conceptual framework, the next section describes the literature review and methodology. This is followed by data analysis and findings. The paper concludes with a discussion and recommendations.
CHAPTER 2

LITERATURE REVIEW AND CONCEPTUAL FRAMEWORK

2.1 Introduction

The literature review will discuss and summarize the relevant studies of this topic, citing the author and the year of the study. It is a clear and logical presentation of the relevant research work done thus far in the area of investigation which is in cash flow aspect. The purpose is to identify and highlight the important variables and to document the significant findings from earlier research that will serve as the foundation on which the theoretical framework for the current investigation can be built and the hypotheses developed. A theoretical framework is a conceptual model of how we theorizes or makes logical sense of the relationships among the several factors that have been identified as important to the problem.

2.2 Literature Review

In this review, we seek to deal with five issues: (a) definitions of SMEs; (b) definitions of business failure; (c) factors influencing SMEs failures; (d) factors influencing cash flow deficiency and (e) Technologies and innovation in cash flow solution. The literature reviews below are very relevant to the study as they are explaining more aspect of SMEs.
2.2.1 Definition of SMEs

The definition of SMEs is based on what has been approved for adoption by National SME Development Council on 9 June 2005 which is issued by the Secretariat to National SME Development Council, Bank Negara Malaysia on 13 September 2005 which are as follows:

Primary Agriculture

General Definition

A small and medium enterprise in primary agriculture is an enterprise with full-time employees not exceeding 50 or annual sales turnover not exceeding RM5 million.

Specific Definitions

A micro enterprise in primary agriculture is an enterprise with full-time employees of less than 5 or with annual sales turnover of less than RM200,000;

A small enterprise in primary agriculture is an enterprise with full-time employees of between 5 and 19 or with annual sales turnover of between RM200,000 and less than RM1 million; and

A medium enterprise in primary agriculture is an enterprise with full-time employees of between 20 and 50 or with annual sales turnover of between RM1 million and RM5 million.
Manufacturing (including agro-based) and Manufacturing (related services)

General Definition

A small and medium enterprise in manufacturing (including agro-based) and MRS is an enterprise with full-time employees not exceeding 150 or with annual sales turnover not exceeding RM25 million.

Specific Definitions

A micro enterprise in manufacturing (including agro-based) and MRS is an enterprise with full-time employees of less than 5 or with annual sales turnover of less than RM250,000;

A small enterprise in manufacturing (including agro-based) and MRS is an enterprise with full-time employees of between 5 and 50 or with annual sales turnover of between RM250,000 and less than RM10 million; and

A medium enterprise in manufacturing (including agro-based) and MRS is an enterprise with full-time employees of between 51 and 150 or with annual sales turnover of between RM10 million and RM25 million.

Services (including ICT)

General Definition

A small and medium enterprise in services is an enterprise with full-time employees not exceeding 50 or annual sales turnover not exceeding RM5 million.
Specific Definitions

A micro enterprise in services is an enterprise with full-time employees of less than 5
or with annual sales turnover of less than RM200,000;

A small enterprise in services is an enterprise with full-time employees of between 5
and 19 or with annual sales turnover of between RM200,000 and less than
RM1 million; and

A medium enterprise in services is an enterprise with full-time employees of between
20 and 50 or with annual sales turnover of between RM1 million and RM5 million.

Definition of Small and Medium Sized Industry in Various Countries

AUSTRALIA

Definition:

Australian Bureau of Stats define on basis of no. of employees

Small less than 20

Medium 21 to 200

Large greater than 200

Key SME Associations:

Council of Small Business Associations of Australia (COSBOA)
BRUNEI

Definition:

SMEs are categorized by the size of the employment opportunities created. Enterprises are small when employing less than 10 people, medium when the numbers are between 10 to 100 and large enterprises when the workforce is more than 100. Under this classification, 98% of the establishment in the private sector is small and medium.

Key SME Associations

- The Malay Chambers of Commerce and Industry
- Chinese Chambers of Commerce and Industry
- International Chambers of Commerce and Industry

The above are federated nationally under the National Chambers of Commerce and Industry which represent the chambers in international forum.

FRANCE

Definition

Enterprise less than 250 employees

Key SME Associations:

Confederation Générale de Petites & Moyens Entreprises (CGPME)
INDONESIA

Definition:

According to Undang-Undang (Regulation) No 9 Tahun (year) 1995, small businesses have a maximum net worth (excluding land and building) Rupiahs 200 million or maximum sales of Rupiahs 1 billion, are owned by Indonesian citizens and are independent i.e. not a subsidiary of, or owned by, or affiliated directly or indirectly with, medium size or big enterprises.

Key SME Associations:

• Indonesian Chamber of Commerce & Industry (KADIN Nasional)

LAOS

Definition: Not available

Key SME Associations:

• Lao Young Entrepreneurs Association

MYANMAR

Definition: Not Available

Key SME Associations:

• Union of Myanmar Federation of Chambers of Commerce & Industry