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A STUDY ON THE EFFICIENT UTILIZATION OF RESOURCES IN COMPANIES

FK MUSWEU*, LEENA JENEFA*

ABSTRACT

Most organizations are constrained with the efficiency utilization of resources. The resources most organizations possess are in form of working capital and non-current assets or fixed assets. When the organization utilizes its resources well it is known to be efficient in the utilization of resources. This paper thus focuses on the efficiency utilization of resources. Initially the objectives of study are outlined in the paper. The paper further describes working capital and non-current asset contained in the literature review and to discuss how the types and preparation of efficiency ratios and how they can be used assess the performance of an organization in terms of resource utilization contained in the findings and discussions. The conclusion and recommendations outlines the suggested solutions. The scope of this paper is focused on the Zambian scenario, particularly the Zambian business entities.

KEYWORDS: Accounts Receivables, Accounts Payable, Asset Turnover, Non-Current Asset Turnover, Working Capital, Non-Current Assets, Cash Management And Efficiency Ratios.

INTRODUCTION

This paper discusses details the description of working capital and non-current asset. In addition it gives information on how to determine if the company is been effective in the use of working capital and non-current assets, particularly in relation to reducing cash being tied up and enhancement of generation of sales and winds up with the conclusion and recommendations.

OBJECTIVE OF THE STUDY

- Provide general understanding of working capital and non-current assets.
- Establish how companies how companies can determine if it is being efficiency in the management of its resources in form working capital and non-currents assets.
- State the tools companies can use improve efficiency it's in the management of resources in form working capital and non-currents assets.

LITERATURE REVIEW

The working capital of every organization constitutes the current assets and current liabilities which make the net working capital calculation explained below.

*Department of Commerce and Management Studies, DMI St Eugene University, Zambia.
Correspondence E-mail Id: editor@eurekajournals.com

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Net working capital is a liquidity calculation that establishes a company's ability to pay off its short term obligations i.e. obligations repayable within one year with resources it is able to raise within a short period i.e. within one year. This measurement is important to manager because it shows the firm's short-term liquidity as well as management's ability to use its assets efficiently.

Short term obligations are referred to as current liabilities and resources that can be raised within a shorter period of time are referred to as current assets.

An organization that fails to meet its current obligations with current assets, it will be forced to utilize its long-term assets, or income producing assets, to pay off its current obligations and may eventually exhibit severe organizational and financial problems.

The focus on current assets is on accounts receivable, inventories and cash while on current liabilities the focus is on accounts payable and the full explanations are given. Accounts receivable refers to amounts receivable from customers in the near future. Inventories are item bought for resale in the ordinary course of business. Cash is described as the most liquid asset an individual or an enterprise can hold. Trade payables are short term obligations held payable to suppliers in the near future.

Non-current asset are assets organizations buy which have a long life and are to be used in the business. They can either be intangible or tangible non-current assets. Examples of intangible non-current assets include copyrights, goodwill, patents and formulas while examples of tangible fixed assets are land and building, fixtures and fittings, machinery and motor vehicles.

Now that we know what working capital is and what non-current assets are, our major concern is on the management of both working capital and non-current assets.

RESEARCH METHODOLOGY

The information use to write this paper is entirely collected through secondary research, specifically from scholarly articles in accounting and financial, various text books in accounting and finance and journals from professional bodies such as the Association of Chartered Certified Accountants (ACCA) and the Association of Accounting Technicians (AAT). The notable sources are specifically stated under reference section at the end of the paper.

FINDINGS AND DISCUSSION

Companies face challenges to the efficient management of both working capital and non-current assets. The initial stage is to assess the performance of the company in terms of the management of working capital and non-current assets and this is solved by the use of efficiency ratios which are discussed below. The suggested solutions will be shown in the conclusion and recommendations.

EFFICIENCY RATIOS

Having gained understanding of working capital and non-current asset now we can discuss how efficient working capital and non-current assets can be utilized by the use of efficiency ratios.

Different industries have different optimum working capital profiles, reflecting their methods of doing business "Page70, 2007, BPP Learning media". The motive is to assess the performance of the business in terms of efficient resource utilization in order to determine the optimum working capital they require for their operations.

Efficiency ratios are also referred to as activity ratios. Efficiency ratios measure how well companies utilize their assets to generate income and the time it takes companies to collect cash from customer or the time it takes companies to convert inventory into cash.

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The common efficiency ratios include:

- Accounts Receivable Turnover Ratio
- Accounts Payable Turnover Ratio
- Inventory Turnover Ratio
- Net Working Capital
- Asset Turnover Ratio
- Non-current assets turnover

They are discussed below in details one by one.

ACCOUNTS RECEIVABLE TURNOVER RATIO

Accounts receivable turnover is the type of efficiency ratio that measures how many times a firm turns its accounts receivable into cash during a period. The ratio looks at how efficient a firm is at collecting its credit sales from customers.

FORMULA

Accounts receivable turnover can be calculated by dividing credit sales by the average accounts receivable for that period.

$$\text{Accounts receivable turnover ratio} = \frac{\text{Credit sales}}{\text{Accounts receivable}}$$

Although usually if there is only sales figure and it is not split into cash and credit sales it is advisable to consider the sales figure to calculate the accounts receivable turnover ratio. A higher ratio is desirable.

EXAMPLE

Tamara has a retail store that sells assorted tools. Tamara offers accounts to all of her main customers. At the end of the year, Tamara's balance sheet showed US$1, 500 in receivables, US$7, 500 of gross credit sales.

The first thing that needs to done in order to calculate Tamara's turnover is to determine net credit sales and accounts receivable. Fortunately they have been already given.

Finally, Tamara's accounts receivable turnover ratio for the year can be determined as follows.

$$\text{Accounts receivable turnover ratio} = \frac{7,500}{1,500}$$

$$= 5 \text{ Times}$$

As calculated above Tamara's turnover is 5 Time and this means that she collects her receivables about 5 times a year.

ACCOUNTS PAYABLE TURNOVER RATIO

The accounts payable turnover ratio is a liquidity ratio that determines whether a company is able to pay off its accounts payable by comparing net credit purchases to the average accounts payable during a period. It portrays how many times a company can pay off its accounts payable balance during the course of a year on average.

FORMULA

The accounts payable turnover is calculated by dividing the total purchases by the accounts payable for the year.

$$\text{Accounts payable turnover ratio} = \frac{\text{Total Purchases}}{\text{Accounts payable}}$$

A higher ratio shows suppliers and creditors that the company pays its bills frequently and regularly. It also implies that new vendors will get paid back quickly and is a drawback as far as the cash position of entity is concerned.

EXAMPLE

During the current year Tamara purchased US$100,000 worth of tools from her vendors for resale. According to Tamara's balance sheet, her accounts payable stands at US$50, 650

Here is how Bob's vendors would calculate his payable turnover ratio:

Accounts payable turnover ratio

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= US$100,000
US$50, 650
= 1.97 Times

Tamara's turnover ratio is 1.97 as calculated above. This means that Tamara pays her suppliers at the rate of 1.97 times a year.

INVENTORY TURNOVER RATIO

The inventory turnover ratio is an efficiency ratio that indicates how effective inventory is managed by comparing cost of sales with inventory for a period. A higher inventory turnover means the company can convert its inventory into cash sooner or within a shorter period.This means that the inventory is extremely liquid and thus the company's cash flows positionis or will be better and thus.

FORMULA:

Inventory turnover
= Cost of sales
Inventory value

Alternatively the ratio can be expressed in inventory days

Managers are keen in making sure the inventory in the entity moves as fast as possible to minimize these costs and to increase cash flows. The longer the inventory sits on the shelves, the t more it ties up the company's cash that may be necessary to finance other operations.

EXAMPLES

Tamara's friend has been happy with her sales staff because they have been moving more inventories this year than in any previous year. She deals in furniture. At the end of the year, her financial statements show inventory of US$5, 000. The cost of sales was US$15, 000.

The Inventory turnover will be calculated as follows

Inventory turnover
=15, 000
5, 000
= 3 Times

This interpreted as Tamara's friend is able to turn over or sale inventory at the rate of 3 times in a period.

ASSET TURNOVER RATIO

The asset turnover ratio is the type of efficiency ratio that measures a company's ability to generate sales from its capital employed by the company. This is enabled by comparing sales with capital employed. It indicates how efficient a company can utilize its assets to generate sales.

Note that Capital employed is the total assets of the business less current liabilities i.e Capital employed = Total assets – Current Liabilities.

FORMULA

The asset turnover ratio is calculated by dividing net sales by total assets (capital employed).

Asset turnover ratio
= Sales
Capital employed

EXAMPLE

Tamara owns a Technology Company is a tech startup company that manufactures a new tablet computer. She is currently looking for new investors and she is proud to have a meeting with her investor prepared to acquire significant number of shares in her company. The investor is interested in knowing how well Tamara utilizes her assets to generate sales, so he requested for her financial statements.

Here is what the financial statements reported:

- Current Liabilities: US$2, 000
- Assets: US$12, 000
- Sales: US$2, 500

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The total asset turnover ratio is calculated like this:

$$\text{Asset turnover ratio} = \frac{2,500}{(12,000 - 2,000)} = 0.25 \text{ Times}$$

Tamara's technology company has the asset turnover of 0.25 times. This implies that for every dollar in assets, Tamara only generates 25 cents.

Non-current assets turnover

Non-current assets turnover is an efficient ratio that tells us about the non-current asset capacity to generate sales. A higher ratio is desirable for the company.

FORMULA:

$$\text{Non-current assets turnover} = \frac{\text{Sales}}{\text{Non-current assets}}$$

EXAMPLE

The following information is available to business entity

- Sale US$4, 000
- Non-current assets US$16, 000

Non-current assets turnover will be calculated as follows

$$\text{Non-current assets turnover} = \frac{4,000}{16,000} = 0.25 \text{ Times}$$

Business's Non-current assets turnover ratio is 0.25 times from the above calculation. This implies that for every dollar in non-current assets, the business generates 25 cents of every non-current assets invested.

CASH MANAGEMENT

Cash is a key component of *working capital management* in companies needed in order to ensure they can meet day-to-day expenses. In addition cash is also required to cushion against unplanned expenditure, to guard against liquidity problems the entity may face. Furthermore cash when available it is an ideal tool to use to take advantage of market opportunities.

Business entities that run out of cash risk being not able to pay debts as they fall due which can have serious operational repercussions and the company may eventually wind up if it consistently fails to pay bills as they fall due.

On the other hand, if companies hold excessive cash then cash becomes an idle asset, the cash could better be invested and generate profit for the company. Companies use the cash flow forecast to show the cash position of the business. A cash flow statement is a statement that shows the estimated cash receipts and payments for the future period under existing conditions.

Cash flow forecasts show the expected receipts and payments during a forecast period and are a vital management control tool, especially during times of recession. "Page 185, 2007, BPP Learning Media"

Using the cash flow forecast companies are able to determine whether they have a short term cash deficit, long term cash deficit, short term cash surplus and long term cash surplus.

CONCLUSION AND RECOMMENDATIONS

The major question that companies face is "what is the optimum level of working capital and non-current assets a company needs in order to be efficient in its utilization of resources?" because if the company reduces it working capital tremendously its profitability is negatively affected as that leads to the reduction of its sales.

As far as working capital is concerned the company may take up the following measures with regard to accounts receivables having a

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credit policy, assessing creditworthiness of customers, establishing Credit limits and following up collections using tools such as telephone calls, reminder letters, withholding supplies, using debt collectors and taking legal actions. As far as inventory is concerned using the economic order quantity (EOQ), just in time (JIT) inventory management systems, reorder levels and inventory management systems such as the bin systems and periodic reviews. As far as account payables are concerned the companies need to strike a balance between making early payments and benefit from cash discounts and good reputation and delaying to pay suppliers and benefit from sufficient cash and cash equivalents.

On the other hand with regard to non-current asset and other assets the company need to ensure that the assets in its possession are all been effectively used to generate sales. Assets that are idle will reduce the efficiency levels of the company in the use of its assets. Perhaps it is a better decision to sale off idle assets and in certain instances the company should replace obsolete assets that are not operating accordingly.

In connection with cash management the measures that an entity will depend the type of cash deficit and cash surplus an entity is facing. If the company is facing a short term deficit of cash it will reduce the receivable accounts by improving debt collection from customers, increase the account payable by delaying to pay suppliers and reducing on the levels of inventory the entities use by not buying stock in excess. On the other hand if the company has long term deficit it can employ the measure of selling of its assets, post pond expenditure on capital investment and consideration for divestment being the last option. Where the company exhibits short term surplus, the company can engage in term investments mostly in the money market, increase the generation of sales by offering customers longer credit periods than before and paying suppliers in time to enhance that the company gains good reputation with its suppliers so that it benefits from reliable supply of raw materials. While if the company experiences long term surplus it can engage in long term investments such the acquisition of securities such as shares and bonds.

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