DETERMINING THE OPTIMUM LEVEL OF WORKING CAPITAL IN THE CAMEROON BUSINESS ENVIRONMENT: THE CASE OF CAMEROON DEVELOPMENT CORPORATION (CDC)

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Abstract: The issue of working capital is very important to the operations of the Cameroon Development Corporation (CDC). Net working capital (i.e. the excess of liquid current assets over current liabilities) is an indispensable component of any business organisation's capital structure. For any company to make profits in order to enhance growth depends on the size of working capital and its proper management. The mismatch of working capital and fixed capital will always bring problems to the financial operations of the company. There must be an optimum size of working capital, because too much working capital is as dangerous to an organisation's working life as too little working capital.

This article sets out the modalities for determining the optimum size of working capital. This coupled with sound working capital management decisions will certainly minimise all technical insolvency risks inherent in the company's business operations.

Shortage of working capital always forces management to go into an overtrading situation (negative working capital). Looking at the case of CDC there is an overtrading situation. This case is used to examine the causes and consequences of overtrading. The paper concludes that organisations must properly manage their working capital in order to achieve growth. To achieve the main objective of this study (i.e. determining the optimum size of working capital) data was collected and analysed from CDC. This is because CDC is a very large corporation and working capital problems are very likely. The study found that CDC has acute working capital problems resulting in losses. These problems stem from poor working capital management approaches employed over the years. Every organisation must seek a point of balance in its working capital in order to avoid a loss-making situation.

INTRODUCTION

Working capital plays a vital role in every company's capital structure. The successful operation of any company lies in its capital structure combination – i.e. the marriage between permanent assets (fixed assets) and circulating assets (working capital).

The Cameroon Development Corporation is Cameroon's second largest employer. It is a huge agro-industrial complex with head quarters in the South -West Province of Cameroon. The Cameroon Development Corporation (CDC) is a public corporation established in 1947 to acquire, develop and operate extensive plantations of tropical crops. This Corporation has 98,000 hectares of land concessions from the Government. Out of the 98,000 hectares 19,795 had by 1999 been planted with different export crops (CDC, 1999).

Cameroon Development Corporation (CDC) has over the years been operating with very little or no working capital. This makes smooth management difficult. The purpose of this paper is to address the particular issue of optimum working capital, so that management can function well. This cannot happen where there is too much working capital as well as when there is a lack of it. Working capital is the positive element that exists when current assets and current liabilities are brought together. When this element is negative, there exists what is known in business as a situation of overtrading. This occurs when the business can no longer pay its debts as they fall due. This may indicate a lack

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of liquidity, but it should be noted that too much liquidity may lead to idle cash, which in turn leads to sub-optimal operations.

In an attempt to address the issue of working capital, we are going to examine carefully the importance of working capital management to an organisation, the composition of working capital and the case of overtrading and its importance. Finally, we shall draw some conclusions and make careful recommendations as to what should obtain in most organisations as far as working capital is concerned.

THE IMPORTANCE OF WORKING CAPITAL

The proper management of working capital in any organisation means that there will be adequate liquidity and profitability (Cooper, 1992). Working capital is the basic measure of an organisation's ability to meet the claims of current creditors and collect current assets by converting debtors into cash. Thus, the careful management of working capital is very necessary from the point of view of both liquidity and profitability.

The importance of working capital is that it provides a cushion of protection against current creditors. How much working capital is adequate to keep the organisation afloat, bearing in mind that when capital is raised from permanent funds, it must be shared properly between permanent capital items and circulating capital (i.e. working capital)?

To determine the optimum level of working capital in any organisation will require considering the composition of assets and liabilities at the point of greatest risk. The point of greatest risk is where the organisation's investment in unsold stock's which is being financed by creditors, is very high. We should note that, when this happens, working capital in relation to current assets is very low, hence the risk to current creditors increases. Once this is known creditors will not supply any more stock, since their position is greatly jeopardised. At this point the protection afforded by working capital to creditors is significantly diminished.

Movements in current assets and liabilities have a significant effect on working capital. Thus each increase in current assets results in an increase in working capital, while a net decrease in any current asset result in a decrease in working capital. Increases in current liabilities results in decreases in working capital, while decreases in current liabilities result in increases in working capital.

When working capital changes have reached a point of concern, that is, at the point of greatest risk to creditors, the question of optimum working capital will always need careful checking.

An analysis of optimum working capital tests the overall financial strength of the organisation. Without working capital the organisation cannot function at all. All organisations need working capital, in the same way that they need such resources as land, labour and entrepreneurship Capital must be organised into permanent capital and circulating capital. These two components must be carefully combined, in order to obtain optimal results. Jones (1992) points out that proper working capital management is central to the life or death of an organisation. It is therefore not just enough to have working capital, but it must be properly managed, which means that the ratio between working capital and current assets should be maintained in an increased rather than decreased position (i.e. working capital turnover rate).

Working capital is very important to an organisation in the running of its daily operations. This implies that working capital always needs a very high turnover rate in order to be managed efficiently (see the working capital operating cycle, table 2). A low turnover rate (as shown in table 2) reflects a situation of poor working capital management which is indicative of the fact that funds are unnecessarily tied up in idle resources (Cooper, 1992). This in turn affects the organisation's ability to acquire more permanent assets thereby limiting its ability to make a profit and create liquidity.

Poor management of working capital means that there is an improper match between available permanent capital and the working capital of the organisation. Working capital must be carefully determined so as to avoid a mismatch between permanent capital and working capital. Where there is a mismatch, the necessary liquidity and profitability positions will not be achieved. Achieving one without the other will certainly create problems, because too much liquidity leads to poor profitability.

To achieve greater profitability means that an organisation's management must have the ability to select profit-making investments, but it cannot achieve this objective if its liquidity is not properly managed. The management of liquidity is the management of working capital. The proper management of working capital is the key to improved profitability in every organisation (Jones, 1992).

Proper management of working capital can be defined as the ability to invest in quality assets, that is those that will not depreciate in value resulting in losses, as well as the ability to mitigate business risks. Management must make sure that very little money is tied up in its working capital items so that sales and profitability can be maximised. As Thexton (1993) points out, money tied up in excess working capital is dead money. The organisation should aim for a very high rate of working capital turnover. He emphasises that working capital should be turned around as many times as possible. "The faster that working" capital can be turned around – the faster the products move from purchase through processing to delivery and payment received – the more profit the business makes. With this in mind, we can define working capital as "the money spent on processing goods and money spent on overheads for the period that the goods are being processed." Working capital is likened to the engine that drives the business; therefore the faster it goes, the more profitable the organisation becomes. Too much working capital is a problem and too little is also a problem. There must be a balance between permanent capital and working capital.

Using the working capital operating cycle, we can carefully estimate the amount of working capital needed during an operating period. Here the working capital operating cycle should be multiplied by the estimated working capital requirements per day. Thus we can say that total working capital requirement are a function of time. The longer the working capital cycle, the larger the amount of working capital needed and vice versa. This acts as a working capital management tool, in order to maintain a company successfully as a going concern (see Table 1).

DETERMINING THE OPTIMUM SIZE OF WORKING CAPITAL

What should be the size of an organisation's working capital? working capital size is very difficult to determine, because it is constantly changing and therefore difficulty to measure. The amount of working capital decided upon by management has an important bearing on the organisation's liquidity. Management must take note of this point and should carefully plan its working capital requirements to achieve good results. It would seem that most small businesses that dissolve do so because of a lack of experience in estimating the working capital requirements.

Any manager (or proprietor) considering working capital requirements should consult a specialist or should make a good estimate of all possible requirements and then add 20% to allow for inflation and unexpected contingencies. Thus an estimate should have an added margin so that the organisation can with reasonable security operate.

The working capital of every organisation plays a dual role – with regard to liquidity and profitability. In the first case, the organisation should avoid keeping large sums of cash (i.e. dead money) which renders it liquid and, secondly, should concentrate on keeping large

Table 1: *Working Capital Operating Cycle*

Add:			
i) Raw material stock Turnover period	=	Average raw material stock x 365 / credit purchases	= x days
ii) Work in progress Turnover period	=	Average work in progress x 365 / cost of goods sold	= x days
iii) Finished goods stock Turnover period	=	Average finished goods stock x 365 / cost of goods sold	= x days
iv) Debtors' turnover period	=	Average debtors x 365 / credit sales	= x days
		Total	**= xx days**
Less:			
v) Creditors' turnover Period	=	Average creditors x 365 / credit purchase	= x days
		Working capital operating cycle	**= xx days**

amounts of the other items of working capital, ensuring that their turnover rate is high. Such items must be carefully managed to increase profitability but avoid too much liquidity.

Carefully managed working capital helps to reduce the organisation's working capital operating cycle (table 2), thereby reducing the amount of working capital required and so increase profitability. With the dilemma of profitability and liquidity strongly to the fore of working capital management, it is advisable that management should carefully control the organisation's working capital. We can use this idea to develop a model for optimum working capital for an organisation.

There are certain costs involved in holding liquidity that is idle for some time as well as costs involved in the procurement of such liquidity. We can therefore use the costs of holding and the costs of acquiring liquidity to establish the optimum size of working capital needed by an organisation. Hence the total cost of holding liquidity plus the total cost of procurement will equal the total cost of the organisation's liquidity.

Thus, we can assume that:

i) The annual demand of liquidity depends on cost estimates for production;
ii) Holding costs depends on the average liquidity held;
iii) The cost of capital is the current discount rate applied on the cost per unit of production; and
iv) The costs involved in the preparation of documents to acquire liquidity can be reasonably estimated.

Therefore,

i) Holding costs $= \frac{L\,t}{2}$ .... equation (i)

Where:

L = amount of liquidity demanded per period

t = cost of capital multiplied by costs of production per unit

ii) Procurement costs = $\frac{Pr}{L}$ .... equation (ii)

Where:

P = Total amount of liquidity demanded
L = Amount of liquidity demanded per period
r = Costs of preparing liquidity requisition orders (legal costs)

The total cost of liquidity is the costs of holding liquidity plus the costs of procurement.

Thus: $\frac{Lt}{2} + \frac{Pr}{L}$ = Total cost .... equation (iii)

$$L = \sqrt{\frac{2Pr}{t}} \quad \text{.... equation (vi)}$$

(See Fig. 1 for graphical representation.) Here table 1 can be used to prepare a careful estimate of the total liquidity requirement of the organisation.

Figure 1 indicates that the cost of acquiring liquidity is very high when acquiring it in higher quantities (i.e. with a small number of orders) and that the holding of liquidity is at its minimum when the cost of acquiring liquidity is equal to the cost of holding liquidity. This is the optimum point (L in fig. 1) of liquidity of an organisation's working capital. From past records, this can be calculated using the working capital operating cycle and the time-money idea (table 2). Using

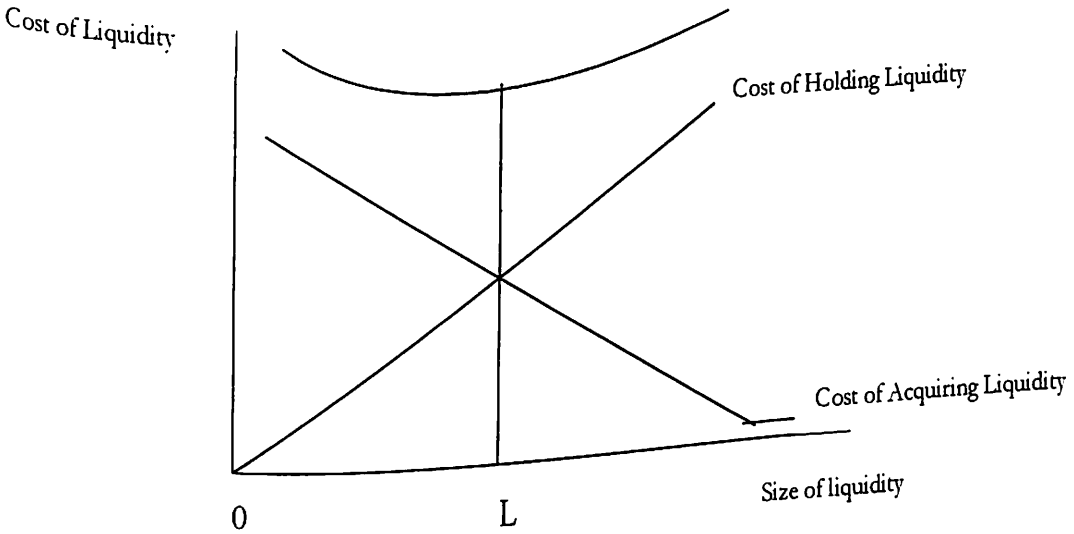


Fig. 1: *Optimum Working Capital Size*

At the point where the cost of holding liquidity is equal to the cost of procurement (fig.1), the liquidity position in an organisation will be at its optimum level.

Thus: At the optimum point:

$$\frac{Lt}{2} = \frac{Pr}{L} \quad \text{.... equation (iv)}$$

Therefore : $L^2t = 2Pr$ .... equation (v)

table 2, it is easier to estimate the amount of working capital required.

From table 2, we can easily use the time-money-based idea to multiply the turnover period by the average amount of money needed to operate in one day. We can do that for all the items involved and sum up the amount (table 3). From table 2 a shows a careful calculation of the working capital operating cycle of the Cameroon Development Corporation shows

that it takes about 153 days for working capital items to be converted into cash. That is a long time in business and therefore indicates that the Cameroon Development Corporation has a very low working capital turnover. Thus, the higher the number of days, the lower the turnover rate and the lower the number of days the higher the turnover rate. In order to be profitable, Cameroon Development Corporation must reduce its working capital operating cycle from the high of 153 days.

Table 3 uses the figures in table 2 to calculate the working capital of the Cameroon Development Corporation for 1995. It indicates that the Cameroon Development Corporation needs a working capital of 6,514,456,530 CFA, but during that year (1995) the financial statement of Cameroon Development Corporation showed a negative working capital of 147,812 CFA (see table 5) making a loss of 2,473,113,000 CFA.

Table 2: *Working Capital Operating Cycle*

i) Raw Material stock turnover period	=	$\frac{57,483,955 \times 365}{137,829,721}$	= 152 days
ii) Work in progress turnover period	=	$\frac{141 \times 365}{36,481,577}$	= 1.4 days
iii) Finished goods stock turnover period	=	$\frac{2,336,510 \times 365}{36,481,577}$	= 23.38 days
iv) Debtors' turnover period	=	$\frac{6,465,330 \times 365}{38,954,690}$	= 60.58 days
v) Less creditors' turnover period	=	$\frac{3,212,482 \times 365}{13,782,971}$	= 84.81 days
			152.55 days

Table 3: *Working Capital Estimate*

i) Raw materials	= Turnover period	x	average working capital	=	WC
	152	x	37,762	=	5,739,758.00
ii) Work in progress	= Turnover period	x	average work in progress		
	1.4	x	0.77	=	1.08
iii) Finished Goods stock	= Turnover period	x	average stock		
	23.38	x	8,699.90	=	203,403.69
iv) Debtors	= Turnover period	x	average debtors		
	60.58	x	19,181.55	=	1,162,018.18
Less:					
v) Creditors	= Turnover period	x	average Creditors		
	84.81	x	6,965.67	=	590,724.42
	Total Working Capital			=	6,514,456.53

Table 4: *Working Capital Cost Table*

No of Orders	*Amount of liquidity (L)*	*Average Working Capital*	*Holding Costs*	*Procurement Costs*	*Total Cost*
6,000.00	1,085,742.76	542,871.38	1,221,460,599.00	300,000,000.00	1,521,460,599.00
12,106.83	538,081.22	269,040.61	605,341,376.70	5,341,376.70	12110,682,753.00
18,000.00	361,914.13	180,955.13	407,153,533.00	900,000,000.00	1,307,153,533.00

The figures in Table 4 when put in graphical representation will appear as in figure 1. Table 4 sets out to test the optimality of the model used in calculating the optimum working capital needed by an organisation.

Using equation (i) to (iv) and the working capital amount in Table 3 we can calculate the optimum working capital of the Cameroon Development Corporation (CDC).

We have to make some assumptions in order to work out the optimum working capital:

i) The cost of capital is 15% (i.e. the market cost).
ii) The cost per unit of production is 15,000 CFA.
iii) The legal cost of liquidity procurement is 50,000 CFA per order.

Using the above assumptions, the optimum working capital can be calculated:

Thus: $\frac{Lt}{2} = \frac{Pr}{L}$ .... equation (iv)

$L^2 t = 2pr$ .... equation (v)

$L = \sqrt{\frac{2pr}{t}}$ .... equation (vi)

Calculate: $L = \sqrt{\frac{2x654,456,530x50,000}{15\%x15,000}}$

L = 538,081.22 CFA (see table 4).

The above indicates that at each and every turn the Cameroon Development Corporation needs working capital of 538,081.22 CFA (see table 4).

IMPORTANCE OF WORKING CAPITAL OPERATION CYCLE

Working capital may be defined as "the bringing together of current assets and current liabilities to effect management efficiency." It is currently best seen as the excess of current assets over current liabilities (i.e. current assets minus current liabilities). Working capital therefore refers to the positive element that remains when current liabilities are deducted from current assets.

Working capital management refers to the careful controlling of the organisation's current assets and liabilities. The various elements of the working capital family must be carefully managed if an organisation is to gain any successful growth in the future. According to Jones (1992), the careful management of working capital must follow a simple equation – "the time-money equation." Thus he points out that the current measurement of working capital is a function of time, i.e. the lead-time of working capital. The size of a company's working capital, therefore, will depend on its working capital operating cycle as caluculated in table1. This is otherwise known as the working capital turnover period. The calculation of the working capital operating cycle requires that we use five variables which are:

a) The raw materials stock turnover period; the length of time needed for raw materials to be converted into cash in order to buy more raw materials. To obtain the raw material stock turnover period we have to divide the average raw material stock by credit purchases and multiply the result by 365 days.

The raw materials stock turnover period is obtained in days.

b) The work-in-progress turnover period; the length of time needed for work-in-progress to be converted into cash. To obtain this we have to divide the average work in progress by the cost of goods sold and multiply the result by 365 days. The work-in-progress turnover period is obtained in days.

c) Finished goods stock turnover period; the length of time needed for finished goods to be converted into cash. To obtain the finished goods stock turnover period we have to divide the average finished goods stock by the cost of goods sold and multiply the result by 365 days. The finished goods stock turnover period is obtained in days.

d) Debtors' turnover period, the length of time needed for debtors to be converted into cash. To obtain the average debtors' turnover period, we have to deduct the credit sales and multiply the result by 365 days. The debtors' turnover period is obtained in days.

e) Creditors turnover period; the length of time needed for cash to be paid out to creditors. To obtain the creditors turnover period we have to divide the average creditors' by the credit purchases and multiply the result by 365 days. The creditors turnover period is obtained in days. To arrive at the working capital operating cycle we add (a) to (d) less (e). The result is obtained in days.

The main aim of calculating the working capital operating cycle is to pinpoint areas where the organisation's liquidity can confidently be improved. The working capital operating cycle can be used to determine how long funds may be tied up in working capital items. In table 2, the working capital operating cycle was calculated for the Cameroon Development Corporation (CDC) to be 152.55 days. Here, we have raw material stock with a turnover period of 152 days, work-in-progress with period of 1.4 days, finished goods stock turnover period of 23.38 days, debtors' turnover period 60.58 days and creditors' turnover period of 84.81 days.

Looking at the figures of the working capital operating cycle, it is reasonable to say that working capital is tied up for too long in raw materials (i.e. 152 days). Also, with a debtors' turnover period of 60.58 days, it seems that debtors take 2 months on average to settle their accounts. The delay of working capital in finished goods is 23.38 days on average. For work-in-progress, the period is 1.4 days which is insignificant. In all, it takes 84.81 days for CDC to pay its creditors.

From such calculations and interpretations, management can be able to know if more working capital will be required from external sources or not and how much. This can be clearly termed as working capital policy decision tool. It is essential that working capital be carefully managed since growth in the organisation can only be achieved by that means. That is, converting cash and Bank into other items of working capital and back into cash and Bank in good time. This mean therefore that if a longer time is taken to achieve this goal, then anticipated growth cannot be easily achieved. Thus that a short working capital operating cycle leads to faster growth and more profits for the organisation.

Table 4 shows the optimum working capital schedule indicating that there is a minimum cost of acquiring working capital. That cost is at the point where the cost of acquiring working capital is equal to the cost of holding idle liquidity. Any other point is not feasible as shown in figure 1: the optimum working capital size (L, fig. 1).

THE COMPOSITION OF WORKING CAPITAL

The working capital requirements of an organisation would basically comprise the following items: cash, bank, stock, debtors, prepayments, creditors, short-term loans and accruals.

a) The cash and bank will initially be used for the acquisition of raw materials, the payment of wages and meeting other operating

expenses. The aim of using cash and bank items to purchase raw materials and finance other expenses is to enable the organisation achieve growth. Growth is realised in the form of profits, which can subsequently be used to finance the organisation's working capital requirements. In this case, there will be no need for any external financing and will enable the organisation to embark on a self-financing policy.

b) Stock is a working capital item which comprises the following items: raw materials, work-in-progress stock, finished goods, tools stock, maintenance stock and consumables depending on the nature of the organisation. For this reason we can classify organisations into three groups:

   i) Manufacturing organisations;
   ii) Trading organisations; and
   iii) Service organisations.

   Stock is the principal working capital item for most organisations, because it brings about growth and profitability. The stock purchased or produced must be of high quality if losses are to be avoided. Slow-moving stock does not encourage growth, but brings about a warddownside risk (less of capital) to the organisation. Bulk-buying without proper calculation of stock levels (i.e. maximum stock level, minimum stock level, re-order stock level and average stock level) may tie down working capital. However, scarce resources (i.e. stock that may quickly run short) may be purchased in bulk during peak supply periods in order to avoid a shortage.

c) Debtors comprise that working capital item which is basically made up of credit sales, the amount owed by customers. No business organisation can be carried out successfully without an element of credit. Debtors must be managed carefully if the business is to achieve any growth. The manager must sell on credit on very short credit terms and carefully select only credit-worthy debtors. Without good management, most business funds will be tied up by debtors and the business will run into liquidity problems.

d) Prepayments is that working capital item which involves amounts which the organisation has paid in advance. It involves funds paid for services that have not been consumed. This item also needs careful management (i.e. by delaying such payments), because the organisation may run short of funds if too much money is paid out for services that have not been rendered. This may not be a good money management strategy, but some organisations are forced to pay for future expenses.

e) Creditors is that working capital item which involves purchases on credit. A business has creditors when it buys supplies on credit. Credit dealings facilitate business operations and enhance growth and the manager may judiciously negotiate with creditors for longer periods of credit.

f) Short-term loans is that working capital item which involves the receiving of loans that have maturity dates of not more than one year. Short-term loans should not be used at all to finance long-term projects to avoid shortage of liquidity when such loans mature or when they are repaid.

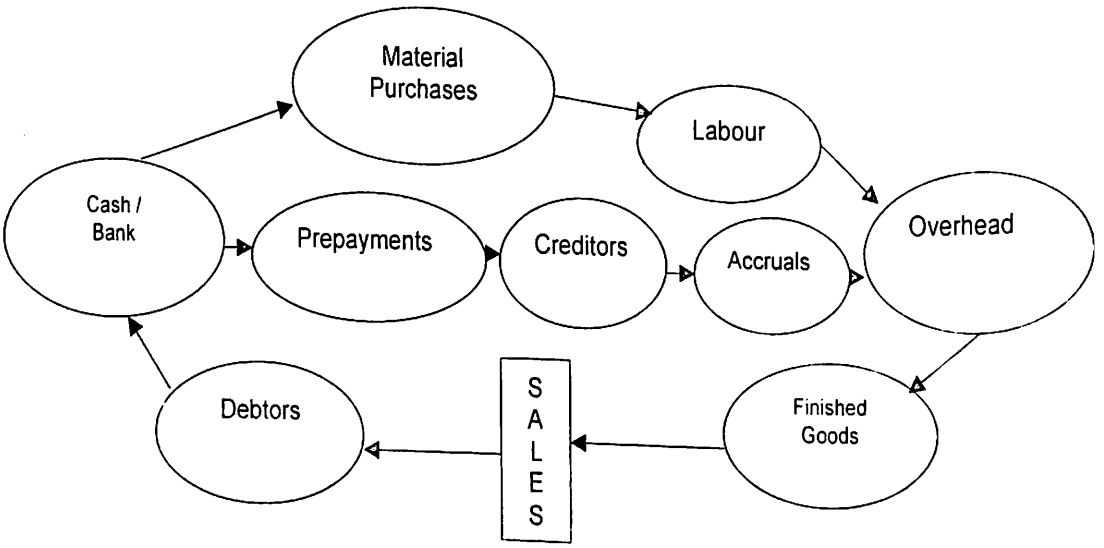
g) Accruals is that working capital item which involves the business owing amounts for services that have been consumed, but not paid for. This may indicate that the organisation has liquidity problems.

Figure 2 is a model that describes the working capital items in diagrammatic form. It shows the movement of working capital in the organisation through the various items involved. It shows the movement of money into stock items, amounts for labour and also overheads. The diagram indicates the flow of money from

debtors to cash and the effects of creditors and accruals on the money supply of the organisation (Jones 1992).

The working capital operating cycle is the total length of time between the input of cash for the purchase of raw materials to enable production take-off and its eventual recovery at the end when cash is received from cash sales or debtors.

At this point, the organisations' volume of trade exceeds its available financial resources. Overtrading often occurs in smaller fast-growing businesses, e.g. provisions wholesalers. It results in situations where proprietors borrow on a short-term basis, but use such credit to finance the organisation's long-term investments. It is a clear indication of working capital mis-management.



Source: Jones (1992) the Control of Working Capital

Fig 2: *The Working Capital Operating Cycle*

LIQUIDITY PROBLEMS

Liquidity problems arise when the organisation can no longer pay its debts as they mature. This situation is described as overtrading and at this juncture the organisation's current liabilities are greater than its current assets. The business may be over-capitalised (i.e.negative working capital). If this is the case then the match between working capital and permanent capital is absent.

When this happens the organisation is certainly going to run into an overtrading situation (Table 5). Table 5 shows a negative working capital situation, indicating that the organisation's volume of trade exceeds its available financial resources. Overtrading occurs during peak periods, e.g. Christmas and Easter. During these periods the overtrading situation of most business organisations create acute liquidity problems.

Table 5: *Working Capital of Cameroon*

Working Capital		CFA '000'
Current Assets		
Stocks:		
Stocks for resale		1,556
Raw Materials and consumable stores		7,002,763
Packing materials		248,556
Produce stocks		3,175,464
Stocks in transit		360,051
		10,788,388
Other Current Assets		
Prepayments	928,163	
Customers	5,255,151	
Personnel	1,144,735	
The State	13,825	
Sundry Debtors	6,980,066	
Adjustment A/c-debit	1,329,883	
Short-term loans	1,046	
Bank Balances	919,378	
Cash Balances	33,277	
Inter-Bank Transfers	1,700,059	
		18,305,583
		29,093,971
Less: Current Liabilities:		
Suppliers	6,362,066	
Customers' Allowance	890,849	
Personnel	2,666,373	
The State	694,174	
Other creditors	25,423,596	
Adjustment A/c-credit	91,609,901	
Liabilities < one year	1,842,596	
Bank overdraft	486,112	
Internal Cash/Bank Transfer	1,596,389	29,241,783
Negative Working Capital		(147,812)

Source: Cameroon Development Corporation (1995)

Table 5 shows that the total current assets amount to 29,093,971 CFA and the total of current liabilities amount to 29,241,783 CFA. Working capital is current assets less current liabilities which results in a negative 147,812 CFA. This puts the organisation in an overtrading position.

These are periods when the volume of business activities increases enormously, but the organisation's finances are limited and therefore

cannot carry the existing levels of operation. At this juncture its daily expenses continue to cause losses resulting from a lack of short-term financing sources. During overtrading periods, the business is losing, because of loss of business activities and high charges resulting from careless financial decisions. To avoid hasty decisions management should plan well ahead. Problems will result from lack of planning (i.e. working capital planning).

As indicated in Table 5 the problems of liquidity in the operations of the Cameroon Development Coorperation generally stems from poor inventory control. Management's inventory policy of investing mostly in very poor quality, slow-moving stock hampers growth. On average a careful study of stock records from 1993 to 1999 indicates that management is holding too many funds in very slow-moving and useless stock items. Investment in stock averages 67.28% of total net assets over the years. Hence there are acute problems of liquidity.

SIGNS OF OVERTRADING

Overtrading results from acute liquidity problems. There are always signs when such problems are imminent:

i) The inability to pay bills as they mature;
ii) The frequency of running to the Bank Manager for overdrafts;
iii) Persistent purchasing on credit, but not paying in good time;
iv) A possible increase mainly in stock or an increase in fixed assets; and
v) Poor current and quick ratios.

Overtrading is always regarded as a dangerous sign, because it brings about the inability to pay bills in good time thereby discouraging creditors giving credit terms. Most businesses use the strength of their overtrading position to increase their profits carefully without going into any long-term loan agreement to raise capital for expansion. Overtrading therefore creates a short-term means of expansion without using permanent capital.

In general, overtrading indicates that the organisation's quick liquid assets (cash and bank) have been carefully employed in more profitable ventures. Therefore, the business becomes less liquid, but more profitable. This means that overtrading situations (not caused by diversion of funds used for the purchase of fixed assets) are always profitable.

Courageous and skilful managers are encouraged to utilise the overtrading technique to make profits and enhance growth. Overtrading situations are often caused by good trading conditions. It is not however the case with table 5 which otherwise indicates that CDC needs external financing, if not they will keep on making losses. They have a net loss of 2,473,113,000 CFA (1995).

CAUSES OF OVERTRADING

It is very likely that overtrading circumstances are mainly induced by favourable trading conditions. Thus, the following can be identified as causes of overtrading:

a) Where the organisation persistently resists a long-term loan during good business periods it will always force its way into an overtrading position. An overtrading situation marks a trade-off for a long-term loan agreement. Management always resists the temptation for a loan, because it carries a higher interest charge than ordinary trade credit.

b) Overtrading takes advantage of an expanding market situation, but without increasing its existing financial resources on a permanent basis. Using bank overdrafts (which are less expensive are certainly a more preferable means of finance).

c) Overtrading may result where the company is stockpiling hoping to sell at a better price in future. Such a policy requires long-term credit and overdraft facilities to acquire the

stock, with the risk of running into liquidity problems.

d) Finally, overtrading may become common during periods of inflation, because of the demand for higher stock costs on input cost with rising prices, more cash is needed in every respect to ease the situation. Inflation is a liquidity trap and may force an organisation into an overtrading position. To avoid such a situation, the organisation must raise additional permanent finance. To maintain growth these causes must be identified and the necessary precautions taken in order to enhance growth.

THE EFFECTS OF OVERTRADING

The above causes of overtrading give rise to its effects, which may be divided into two classes:

a) Positive effects – the main positive effect of overtrading is the generating force of short-term profits at less cost than if permanent capital were to be made available.

b) Negative effects – there is acute cash shortage which may lead to creditors being dissatisfied, refusing the organisation trade credit, leading in turn to severe consequences. Management may be forced to give up short-term profits in order to acquire liquidity from long-term capital sources.

Proper control must be carried out on capital expenditure in order to allow for adequate working capital. Where this is in place, the problems of overtrading will be phased out.

CONCLUSION

Prudent management of working capital as a veritable source of organisational survival becomes imperative especially in the short term for operational activities to lead to long-term growth. Working capital must therefore be tightly controlled in order to allow the organisation to run smoothly. From the study, CDC during the period 1990 – 1995, does not maintain an adequate working capital position which leads to the conclusion that it is financing short-term operations with long-term capital. This is very precarious and it is strongly recommended that proper management of its working capital is put in place in order to achieve profitability. Working capital is the very life-blood of every organisation strengthen the liquidity position of the organisation (i.e. short-term survival) and leading to the profitability needed for long term survival. However, the situation of the particular case in shown the financial statements is judged to have been caused by the holding of high stock levels for long periods. Working capital is a very important component of an organisation's total capital and is necessary throughout the organisation's entire working life. A careful blend of fixed capital and working capital would therefore assist the organisation to grow and achieve long-term survival.

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APPENDIX

Table 7: *Working Capital*

	FCFA '000'	FCFA '000'
Current Assets:		
Stocks (assorted)	8,797,131	
Prepayments	1,075,430	
Customers	1,633,615	
Personnel	153,024	
State	21,951	
Sundry Debtors	1,757,527	
Adjustment Account – Debit	441,484	
Short loans	476	
Bank Balances	1,666,043	
Cash Balances	28,897	
Cash in Transit	477,414	
Inter Bank Transfer	267,226	16,320,218
Current Liabilities:		
Suppliers	2,245,820	
Customer Advances	452,242	
Personnel	1,914,255	
State	1,590,911	
Other Creditors	3,163,466	
Adjustment Account – Credit	2,079,282	
Liabilities < one year	619,746	
Discounted invoices	1,539	
Bank Overdraft	503,483	
Internal Cash/Bank Transfers	584,496	13,555,240
Total Working Capital		2,764,978

Source: Cameroon Development Corporation (CDC) 1993