

# WORKING CAPITAL MANAGEMENT PRACTICES OF SMALL AND MEDIUM ENTERPRISES IN VIETNAM

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## 1. Introduction

In the developed countries such as the U.S., Canada, England and Australia, it has long been recognized that the efficient management of working capital is crucial for prosperity and survival of small and medium enterprises (SME) (Grablowsky, 1984; McMahon and Holmes, 1991). Previous researchers indicated that "poor" or "careless" financial management is a major cause of small business failure (Berryman, 1983) and some of the most important internal problems SMEs need to identify are inadequate capital, cash flow management, and inventory control (Dodge, Fullerton and Robbins, 1994). A recent survey conducted by the Insolvency Practitioners Society (CIMA, 1994) in the UK indicated 20% of firm failures were due to bad debts or poor receivable management.

Previous research findings related to working capital management practices indicated that if the financial management practices, especially working capital management, could be significantly improved in the SME sector, then few firms would fail, and therefore working capital management practices are extremely important for SMEs. Nevertheless, in the emerging countries such as China and Vietnam, almost no previous research has been concerned with working capital management practices. Therefore, the main purpose of this paper is to report findings of a survey of working capital management practices of SMEs conducted in September 2000 in Vietnam. These findings provide deeper insights into working capital management practices and provide suggestions for future research in the emerging countries like Vietnam.

## 2. Research method

(See EDR, N° 83, July 2001, p.3)

## 3. Research findings

### a. Cash management practices

In examining cash management practices, previous researchers have mainly focussed on examining areas such as cash budgets, cash balance and cash surplus or shortage. This subsection presents descriptive find-

ings of cash management practices of the sample of 99 trading and 51 manufacturing SMEs in Vietnam.

For cash budget preparation, 38% of respondents indicated that they always prepare cash budgets whereas only 5% never had a cash budget prepared (Table 1). In addition, Table 1 reveals that 76% of SMEs prepared cash budgets on a monthly basis, 11% weekly, and about 5% quarterly. The remainder prepared cash budgets by semiannual and annual periods. As such, the monthly period is frequently used by Vietnam SMEs in preparing cash budgets.

outflows without any management policies.

Additionally, Table 2 indicates that 83% of Vietnam SMEs, which often or always set up a cash balance policy, had the decision on target cash balance based on the owner/manger's experience. Percentage of SMEs which applied theories of cash management in determining the target cash balance was not significant. This suggests that theories of cash management have not been popularly implemented in Vietnam practices and owner/manager's experience remains more important than theoretical implication in cash man-

Table 1: Preparing cash budgets

Frequency of preparing cash budgets	No. of firms	Percentage
Never	8	5.4%
Rarely	7	4.7%
Sometimes	17	11.4%
Often	61	40.9%
Always	56	37.6%
Total	149	100.0%
Period for preparing cash budget		
Never	9	6.0%
Weekly	16	10.7%
Monthly	114	76.0%
Quarterly	7	4.7%
Semiannually	2	1.3%
Annually	2	1.3%
Total	150	100.0%

Source: Data analysis for the study

For cash balance determination, Table 2 reveals that only 12.6% of responding firms often or always, while about 40% rarely or never determine target cash balances. As such, a common trend is that Vietnam SMEs rarely pay attention to setting up a cash-balance policy. Most SMEs consider cash-balance as differences between cash inflows and

agement.

In term of cash shortage experience, 20% SMEs had never or rarely been short of cash, only 2.7% of responding SMEs often or always had insufficient cash for expenditure. Conversely, about 40% of SMEs in the sample had a surplus of cash, in which 2.7% answered that they always had cash surplus for spending (Table 3). This finding is consistent

Table 2: Cash balance determination

		No. of firms	Percentage
Determining the target cash balance	Never	12	8.0%
	Rarely	46	30.7%
	Sometimes	73	48.7%
	Often	14	9.3%
	Always	5	3.3%
	Total	150	100.0%
Cash balance determination	Based on theories of cash management	1	.7%
	Based on historical data	21	14.0%
	Based on owner/manager's experience	124	82.7%
	Others	2	1.3%
	No answer	2	1.3%
	Total	150	100.0%

Source: Data analysis for the study



with Kack and Lindgren (1999), and Vuong Quan Hoang (1998) findings, which indicated SMEs in Vietnam seems likely to reserve much cash and have high current ratios.

Tables 4 indicates 80% of respondents always or often sell their products or services on credit and only 2% never sell on credit. However, only 63% of SMEs that always or often

els and bad debts based on monthly periods. However, there are 4.7% who answered that they never review their bad debts (Table 5). As such, like cash management practices, monthly periods are still popularly used by SMEs in reviewing receivable levels and bad debts.

On the question of percentage of bad debts compared to sales, 89% of responding firms indicated that they have not exceeded 10% of bad debts (Table 6). This figure is not high under conditions of finance source shortage and shows that Vietnam SMEs are relatively skilled in managing receivables. Nevertheless, a few SMEs answered that they do not know their percentage of bad debts, and others did not answer this question.

#### c. Inventory management practices

On inventory management practices, respondents were asked questions related to preparing and reviewing inventory budgets, determining inventory levels, and using the economic order quantity (EOQ) model. Below are descriptive findings of inventory management practices of SMEs in the sample.

Table 7 shows a relatively high percentage (86%) of Vietnam SMEs in the sample always or often review inventory levels and 80.7% always or often prepare inventory budgets. Only about 5% never prepare inventory budgets.

When asked how they determined the level of inventory in preparing inventory budgets, 94% of responding firms answered they determined inventory level based on owner/manager's experience, only 2% were based on theories of inventory management (Table 8). On the other hand, SMEs very rarely use the

**Table 3: Cash surplus or shortage**

		No. of firms	Percentage
Occurring cash shortage	Never	12	8.0%
	Rarely	18	12.0%
	Sometimes	116	77.3%
	Often	3	2.0%
	Always	1	.7%
	Total	150	100.0%
Occurring cash surplus	Never	7	4.7%
	Rarely	82	54.7%
	Sometimes	51	34.0%
	Often	6	4.0%
	Always	4	2.7%
	Total	150	100.0%
Cash surplus investment	Bank deposit	28	18.7%
	Treasury bill purchase	1	.7%
	No investment	113	75.3%
	Others	1	.7%
	Not cash surplus	7	4.7%
	Total	150	100.0%

Source: Data analysis for the study

Regarding cash surplus investment, it was surprising that up to 75% of responding Vietnam SMEs did not invest cash surpluses for profitable purposes. About 19% deposit cash surplus in bank accounts for interest and almost no firms used cash

sell products or services on credit answered that they always or often set up a credit policy for the customers. Seven percent never have credit policies for the customers but they tend to sell on credit to anyone who wishes to buy.

**Table 4: Sales on credit and credit policies**

		No. of firms	Percentage
Sell products or services on credit	Never	3	2.0%
	Rarely	7	4.7%
	Sometimes	19	12.7%
	Often	78	52.0%
	Always	43	28.7%
	Total	150	100.0%
Set up credit policy to the customers	Never	11	7.3%
	Rarely	15	10.0%
	Sometimes	30	20.0%
	Often	60	40.0%
	Always	34	22.7%
	Total	150	100.0%

Source: Data analysis for the study

surplus to buy money-market instruments such as treasury bills, commercial papers or the equivalents (Table 3). This is explained as the result of the underdeveloped money market in Vietnam, therefore, firms can not use cash surplus to purchase short-term investment instruments for profitable objectives.

#### b. Receivable management practices

Regarding receivable management practices, respondents were asked questions concerned with credit sales and policies, reviewing levels of receivable and bad debts, and percentage of bad debts compared with sales. Below are descriptive findings of receivable management practices of SMEs in the sample.

**Table 5: Frequency of reviewing receivable levels and bad debts**

		No. of firms	Percentage
Review levels of receivables	Weekly	16	10.7%
	Monthly	124	82.7%
	Quarterly	8	5.3%
	Annually	1	.7%
	No answer	1	.7%
	Total	150	100.0%
Review bad debts	Never	7	4.7%
	Weekly	9	6.0%
	Monthly	120	80.0%
	Quarterly	7	4.7%
	Semiannually	3	2.0%
	Annually	3	2.0%
	No answer	1	.7%
	Total	150	100.0%

Source: Data analysis for the study

In reviewing receivable levels and bad debts, a relatively high percentage of SMEs (about 80%) in the sample reviewed their receivable lev-

"Economic Order Quantity Model" (EOQ) in inventory management. Up to 90% of SMEs revealed that they have never known this model, 6%



Table 6: Percentage of bad debts compared to sales

		No. of firms	Percentage
Bad debt percentages	Less than 5 % of sales	66	44.0%
	5 -10% of sales	67	44.7%
	10 -20% of sales	12	8.0%
	More than 20% of sales	1	.7%
	Don't know	2	1.3%
	No answer	2	1.3%
Total		150	100.0%

Source: Data analysis for the study

know but never use the model, while only 1.3% often used the model.

Practices of inventory management as mentioned above show that Vietnam SMEs have very low knowledge of management theories. Although they often review inventory levels and prepare inventory budgets, ability of applying theories of inventory management in inventory budgeting is very limited.

not know how to use the temporary cash surplus for profitable purposes. This finding reveals that cash surplus rather than cash shortage is a problem for these SMEs. Another problem is how to invest the temporary cash surplus for profitable purposes. That SMEs have to keep much more cash balance is recognized as essential under conditions of business environment uncertainty. How-

Table 7: Frequency of reviewing inventory levels and preparing inventory budgets

		No. of firms	Percentage
Review inventory levels	Never	2	1.3%
	Rarely	8	5.3%
	Sometimes	11	7.3%
	Often	52	34.7%
	Always	77	51.3%
	Total	150	100.0%
Prepare inventory budgets	Never	7	4.7%
	Rarely	9	6.0%
	Sometimes	13	8.7%
	Often	52	34.7%
	Always	69	46.0%
	Total	150	100.0%

Source: Data analysis for the study

#### 4. Conclusions and discussions

On cash management, the following conclusions are drawn from the investigation and discussion on cash management practices of SMEs in Vietnam. Firstly, about 80% of SMEs always or often prepare cash budgets, and preparing and reviewing cash budgets are frequently based on monthly periods. The opinion of many researchers is that most the owners or managers of SMEs in Vietnam have rarely been trained in skills at financial management. However, the current findings show that SMEs are familiar in using cash budgets as tools in planning and controlling cash flows of the firm. On the other hand, about 80% SMEs determine cash balance based on the owner/manager's experience. This suggests that experience is more important than theory in practising cash management.

In addition, only 2.7% of responding Vietnam SMEs always or often are short of cash for spending while about 40% always or often have a surplus of cash. Nevertheless, only 19% of SMEs deposit cash surplus into bank accounts, while up to 75% did

ever, this affects SME profitability and a trade-off between liquidity and profitability needs to be considered carefully.

Because the Vietnam money market has not been created, unlike SMEs in the developed countries, SMEs in Vietnam could invest in money market instruments such as treasury bills, commercial papers, bank acceptances, and so on for short-term investment purposes. In fact, SMEs do not have opportunities rather than did not know how to invest the temporary cash surplus for profits. This conclusion leads to the demand for a money market, which

should be developed together with capital or stock markets instead of being separately developed, as seen in recent years. In addition to developing money market, a recommendation for policy-makers is that the links between components of financial market including money market, capital market and foreign exchange market, need to be considered as a whole.

Regarding receivable management, 80% of SMEs always or often sell their products or services on credit and 63% always or often set up their credit policies to the customers whereas 7% of SMEs tend to sell on credit to anyone who wish to buy. This finding shows that selling products or services on credit is a common trend among SMEs in Vietnam, especially under conditions of strong competition market. In consequence, receivable management practices have become extremely important and reviewing levels of receivables and bad debts need to be conducted frequently.

Therefore it is not surprising that most SMEs review their levels of receivables and bad debts monthly. As a result, the percentage of bad debts was still controllable and maintained at a relatively appropriate level. The majority of SMEs have the percentage of bad debt less than 10% of sales. This is considered suitable.

Finally, for inventory management practices, SMEs still have little knowledge of management theories. Despite this, they often review inventory levels and prepare inventory budgets, but the ability of applying theories of inventory management in inventory budgeting is very limited. Over 90% of SMEs have their decisions on inventory level based on the owner/manager's experience and about 90% did not know anything about the EOQ Model. Like cash management, the owner or manager's experience was again found to be more important than application of theories of inventory management. ■

Table 8: Basis of determining inventory levels and using EOQ Model

		No. of firms	Percentage
Inventory level determination	Based on theories of inventory management	3	2.0%
	Based on historical data	3	2.0%
	Based on owner/manager's experience	141	94.0%
	Others	3	2.0%
	Total	150	100.0%
EOQ Model application	Do not know this model	134	89.3%
	Know but never use	9	6.0%
	Sometimes use	5	3.3%
	Often use	2	1.3%
	Total	150	100.0%

Source: Data analysis for the study