INVENTORY MANAGEMENT PRACTICES AND PROFIT PERFORMANCE OF MEDIUM SCALE FOODS INDUSTRY IN NIGERIA

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ABSTRACT

The study examines the impact of inventory management practice on the profitability of Medium Scale Food Industry in Nigeria. There is a dearth of study relating to inventory management practice impact on medium scale food industry in a developing economy like Nigeria. Both primary and secondary data were employed in the study using simple random sampling; sampled of medium scale industrialists and their workers were selected. Also, samples of seven companies financial data from period of 2002 to 2012. Employing regression techniques, the impact of inventory management on profitability was analysed using stata10 statistical packages. The result of data analysis and hypotheses tested indicated strong and positive relationship between approaches of inventory control and financial performance (r=0.794). This implies that approaches of inventory control affected financial performance by 79.4%. It further showed that raw material (f=2.609) work –in- progress (f=6.552) were more significant to profitability than finished goods (f=1.859) Conclusion from the pooled result showed that there was a strong relationship between inventory management practice and profit performance of selected medium scaled food industry, therefore, good inventory management approach has significant effect on profitability of medium scale food industry.

Keywords: Inventory; Inventory management practices; Medium scale Foods industry; Profitability

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1.1 Introduction

Evidence from the literature showed that inventories are crucial and important in the day to day smooth running of operations of business organizations (Adeyemi and Salami, 2010). Olowolaju (2013) believed inventory is a vital asset, necessary for effective operation of any business organization. Alm, (2000) averred that the inventory management system operated will affect the profitability of an organization directly and indirectly. Inventory control involves the coordinating of materials availability, controlling, utilization and procuring of materials. Managing safety stocks has been a key concern in the context of inventory systems. While it seems to be very easy to place the safety stocks in inventory management in black and white, it becomes extremely complicated when varying situations are involved. Inventory is the largest asset item on a manufacturer's or distributor's balance sheet. As a result, there is a lot of management emphasis on keeping inventories down so they do not consume too much cash.

The extent to which inventory management practices impact on the performance of medium scale foods companies requires adequate exploration in the Nigerian context. Medium scale industries have in most cases been classified along with small scale industries. However medium scale industries operate on larger scale than small businesses. The benefits of Small and Medium scale enterprise (SME's) to any economy were easily noticeable,

Literature suggests that inefficient management of inventory could lead to under utilisation of capacity and loss of profit. The under utilisation of capacity can aggravate the unemployment problem in any economy (Diana, 2011; Olowolaju, 2013). According to Olowolaju (2013) in many developing economies, small and medium scales enterprises employ substantial number of the work force Therefore, efficient management of inventory in small and medium scale manufacturing firms is imperative for meaningful economic growth of any country. Proper inventory management and control also require an organization to undertake stocking and use appropriate method to value stock so as not to under or over state profits (Kotabo, 2002). According to Diana (2011), companies incur substantial costs in the procurement and maintenance of inventories, which costs form a large portion of production costs. According to Lwiki, Ojera, Mugenda and Wachira (2013) Manufacturing firms apply various techniques in the management of their inventories. The practices adopted have a significant impact on returns, profitability and volume of sales. Manufacturing firms that efficiently apply these practices shave an excellent financial performance.

Garrison and Noreen (2000) opined that the selection of the right level of inventories involves balancing three groups of costs. These cost are: inventory ordering cost, inventory carrying costs, the cost of not carrying sufficient inventory and opportunity cost. Inventory costs include: carrying costs such as storage and insurance; ordering costs like transporting and store placement; and stock out costs like redundancy and loss of sales. A company cannot achieve an outstanding performance without proper and efficient management of materials. Materials are as much as cash itself and any theft, wastage and excessive use of materials are of immediate financial loss and leads to poor performance of a company (Kotabo, 2002; Laugero, 2002; Iwarere, 2000).

Studies have confirmed significant and positive correlation between inventory management and improved profit performance. Hence, the focus of this study is on the appraisal of inventory the influence of management practices on the profit performance of medium scale food industry in Nigeria. Both small and medium scale businesses are central to economic growth and development of any country and therefore must be given adequate attentions as regards anything that can affect their operations and performance.

1.2 Statement of the Problem

The basic goal of any material control system is to develop and manufacture goods that can be marketed at a profit. Therefore more than any other forms of business, production entities face serious problems in their bid to continue production. Modern inventory management processes utilize new and more refined techniques that provide for dynamic optimization of inventories to maximize customer service with decreased inventory and lower costs. These improved approaches to inventory management are of major consequence to overall competitiveness where the highest level of customer service and delivered value can favorably impact market share and profits. Efforts of many countries to encourage small and medium scale industrial enterprises have been mostly on finance without recourse to other germane problems affecting performance. According to Olowolaju, (2013) Small and Medium scale manufacturing industries are in most cases faced with the problems of inadequate inventory of raw materials and spare parts. These shortages often lead to breaks in production schedule, machine breakdown and low capacity utilisation and thus constituted a barrier to their effective growth.

Investigation of the impact of identified inventory management approaches on profit performance of the Nigerian medium scale food industries becomes the gap making for the relevance of this study. The influence of inventory management practices on the profit performance of the selected medium scale food companies between 2002 and 2012 were analyzed through data collected from both questionnaire and their financial records. Although the study was conducted on medium scale food companies in Lagos state, the findings were generalized to include all medium scale food companies in Nigeria.

1.3 Objectives of the Study

i. Assess how each specific inventory management practices affect profit of sampled firms.
ii. Examine the relationship between inventory management practices and the profit performance of medium scale food industry.

1.4 Research Hypotheses

HO_2: There was no significant effect of each specific inventory management practices on profit performance of medium scale food industry.

HO_3: There was no significant relationship between a firm's performance and its inventory management practices.

2.0 Literature review

2.1 Economic Importance of Small and Medium Scale Enterprises (SMEs)

Many economies, developed and developing have came to realize the value of small and medium scale businesses. Studies have shown that small businesses in many countries are mechanisms for stimulating indigenous entrepreneurship, enhancing greater employment opportunities per unit of capital invested and aiding the development of local technology (Sule, 1986; World Bank, 1995; Orisanaye, 2000; Akande, 2005).They are seen to be characterized by dynamism, witty innovations, efficiency, and their small size allows for faster decision-making process. Governments all over the world have realized the importance of this category of companies and have formulated comprehensive public policies to encourage, support and fund the establishment of SME's. Developments in small and medium enterprise are a sin quo non for employment generation, solid entrepreneurial base and encouragement for the use of local raw materials and technology.

Adelaja (2006) averred that interaction between Small and Medium Enterprises (SMEs) operators is a factor for the development of SME's in Nigeria. Anwatu (2006:3) said that 75% of the private sector is dominated by Small and Medium Enterprises (SMEs) reiterating that Organized Private Sector (OPS) is the engine of growth and creator of wealth and employment. The Nigeria Chamber of Commerce, Industry, Mines and Agriculture (NACCIMA 2006:14) argued that small scale enterprises SSEs are the vehicle for rapid industrialization and development of any nation. Eke (2007) argued that MSMEs account for over Ninety three percent of the total entrepreneurs in Nigeria.

In Nigeria, as well as in most other countries of the world, small and medium-sized companies (SMEs) represent the vast majority (99%) of all enterprises (OECD, 1998). Their contribution to economic growth, job creation and innovation is widely recognized (Audretsch and Keilbach, 2004; Van Stel et al., 2005). The benefits of SME's to any economy were easily noticeable, such as contribution to the economy in terms of output of goods and services; creation of jobs at relatively low capital cost, especially in the fast growing service sector; provided a vehicle for reducing income disparities; developed a pool of skilled and semi-skilled workers as a basis for the future industrial expansion; improved forward and backward linkages between economically, socially and geographically diverse sectors of the economy; provided opportunities for developing and adapting appropriate technological approaches; offered an excellent breeding ground for entrepreneurial and managerial talent, the critical shortage of which was often a great handicap to economic development, among others (Akande, 2005; Adelaja, 2006; Oladejo, 2008; Adereti and Oladejo, 2008).

2.2 Empirical Review of Inventory Management and Control Practices

Brackus (2000) argue that material control is concerned with two parts of Accounting; physical property and value of the property. Brackus (2000) shows material control as one of the policy procedures employed in the management of material s and these include internal checks as in continuous, period, spot and or any other type of control

established by management to carry out activities aimed at ensuring an effective and efficient material management procedure. Olowolaju (2013) determine the actual reasons for non application of scientific inventory management techniques in the SMEs by collecting data on two hundred and twelve organizations SMEs in Food, Textiles, Wood and Metal Products sectors in South Western Nigeria. It was established that non usage of scientific inventory techniques for better inventory decision was due to lack of skilled personnel and inadequate data to use inventory models; and low level of ICT in the SMEs.

Other forms of material control include ensuring high security of the store house and stock yard, good custody of keys, limiting access to premises and making of materials as in coding, to minimize theft, segregation of prescribed item. Krowicki (1962) examines application of various materials control techniques on the fact that material control procedures vary in complexity and accuracy. Brackus (2000) noted that Accounting material control is concerned with the safe guarding the enterprises property in form of materials by properly recording the receipts, consumption of materials and the balance in storage. Nyanga (2000) said that in any efficient business material levels are established with as much care as production levels, a careless choice of the material level can easily precipitate production slow down caused by lack of badly needed materials. He continues that as a result of tighter controls over materials, items and meticulous records keeping, the cost of maintaining adequate levels of materials is reduced with adverse effects on the continuity of operations.

According to Main (2000), for project involving the large scale use of critical resources, the owner may initiate the procurement procedure even before the selection of a constructor in order to avoid shortages and delays.

According to Kotabo (2002), though there are many systems for control of stock, both manual and automatic, there are really two basic approaches on which these systems are based. Recording method which may take place either when materials fall to a pre-determined level or according to each situation discovered when levels are received on a periodic regular basis.

2.3 The Relationship between Approaches of Inventory Control and Financial Performance

According to Lynch (2005), the main objective of inventory management is to minimize the total cost of relevant costs to ensure profitable operations. According to Pandey (1995), in many cases where inventory management decisions have been effective, inventory planning models have been effective; inventory- planning models have been developed and implemented focusing especially on the twin problems of inventory size and timing. The scholars agreed that profitability would only be achieved at optimum level of relevant costs i.e. holding costs and ordering costs (Lynch, 2005).

Morse (1981) agreed with other scholars and further observed that, because of the variation in lead-time and the daily demand for inventory, inventories are cushions to prevent "Stock out" and the resulting loss of sales or disruption of production. As already noted above, in

a merchandising establishment, stock out costs includes the extra costs of processing back orders and opportunity cost of lost sales is frequently specified as the selling price less the invoice price, opportunity costs are considered greater if dissatisfied customers subsequently patronize other establishments. In this case, the profitability of an organization remains fragile if no proper controls are considered greater it dissatisfied customers subsequently patronize other establishments. In this case, the profitability of an organization remains fragile if no proper controls are ensured.

Excessive inventories are the enemy of retail profitability. For inventory management to be an effective profitability improvement tool, corporate culture must ensure that employees are empowered to make it successful (Laugero, 2002). Organizations like Black and Decker fully realize the relationship between inventory production and profit. This is an international Corporation, with annual sales in excess of and 1 billion. It is the world's largest manufacturer of power tools, and because of large required investment in inventory and the total cost associated with such, managers are alert for ways to control inventory (Ivancevich, 1990).

Lucey (1992) says that inventory management is an important area of financial control, which is often neglected not knowing that a small percentage saving on inventory costs will represent millions of shillings on natural scale. All stocks represents on investment so they should keep to an absolute minimum.

Lwiki, Ojera, Mugenda and Wachira (2013) examined the impact of inventory management practices on the financial performance of sugar manufacturing firms in Kenya, by analyzing the extent to which lean inventory system, strategic supplier partnership and technology are being applied in these firms. The research survey was conducted in all the eight operating sugar manufacturing firms from the period 2002-2007. The primary data was collected using structured and semi- structured questionnaires administered to key informants in the organizations. Secondary data was obtained from annual financial performance statements available in the year Book sugar statistics. Descriptive statistics was used to test the impact of inventory management practices and Correlation analysis was used to determine the nature and magnitude of the relationship among inventory management variables. The results indicated that there exists a positive correlation between inventory management and Return on Sales and also with Return on Equity which were found to be statistically significant at 5% level.

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3.0 Methodology

The study areas were medium scale foods and drinks companies in Lagos state. There were fifteen medium scale food companies registered with Lagos Chamber of Commerce and Industry as at 2012. Out of this existing food companies only seven were purposively selected based on geographical spread across Lagos state as such that one out of food companies in a particular area was selected for the purpose of the study. Crown Drinks ltd, Classic beverages ltd, Formossa Bottling Coy ltd, Fumman Bottling ltd, Chi ltd and Sunny Foods and Beverages ltd**.** Samples for the study were drawn from the seven selected food companies in Lagos State. Samples were drawn from staff members comprising of purchasing officers, store keepers, site foreman, site workers,

accountants, technical managers, administration managers and the general managers of the selected food companies. Fifteen staffs, each working in the production related and stock planning units were selected purposively for the purpose of the study.

Both primary and secondary data were employed in the course of the study. Primary data was collected through structured questionnaire and administered on the staff members of the selected food companies. The secondary data were the financial records and books of account of the selected companies to obtain information about the performance of the companies between 2002 and 2012. Seven food companies were selected in Lagos State as the sample frame. 15 staffs were picked from eight departments of each of the seven sampled companies, making total of 120 respondents. However only 115 questionnaires administered and retired were found useful for the purpose of the study. These 115 questionnaires were therefore used for the data analysis to achieve the objective of this study. Quantitative data were collected by the use of questionnaire. Self-administered questionnaires were designed using Likert scale, and they were distributed to staff members of the food companies selected for the study.

Descriptive statistics like frequency table, percentage analysis and regression technique, correlation and F test analyses were used to analyze the data obtained for this study. Regression analysis was used to analyze the objective: how each Inventory Management Practices affects profit while correlation analysis and F test measured the relationship between Inventory Management Practices and Profit Performance.

3.1 Empirical Model Analysis of relationship between inventory management practice and profitability

Multiple regressions and ordinary least square were employed to model the objectives. The profit performance if hypothesized to have been influenced by Raw Materials (RM), Work in progress (WIP), finished goods (FinGds). The measurement of these variables was presented in Table 3. *The model was specified as:*

PERF = f (RaM, WIP, FinGds) ..... (3.1)

Explicitly, the model was specified as:

Y = f (RaM, WIP, FinGds)…… (3.1)

Explicitly, the model was specified as:

$Yn = \alpha_0 + \beta_1 RAM_{it} + \beta_2 WIP_{it} + \beta_3 FinGds_{it} + e_{it}$…….(3.2)

Y is the dependent variable which assumes a binary form in the regression model and represents profits performance. It represents Pr_i (profit in t,|Loss in t − 1). It assumes the value of 1 if firms effectively utilize all the three inventory management practices and 0 if not. The panel least square is similarly specified as:

$Y = \alpha_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \ldots\ldots\ldots\ldots\ldots \beta_n X_n + e$

However, y, the dependent variable is represented by the profit margin in the given period of the selected firms.

The second objective of this study was adopted correlation analysis. Correlation is a measure of association between two variables. It is used to determine the degree to which two or

more variables vary together. Correlation does not suggest a cause-effect relationship but only the degree of parallelism or concomitance between the two variables. If all the values of the variables satisfy an equation exactly, the variables are perfectly correlated or that there is perfect correlation between them.

The Pearson Product Moment Correlation equation can be specified as follows:

$$r = \frac{N\sum XY - (\sum X)(\sum Y)}{\sqrt{[N\sum X^2 - (\sum X)^2][N\sum Y^2 - (\sum Y)^2]}} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (3.9)$$

Where:

$\sum XY$ = Sum of the product of e-payment adoption measurement and book keeping method

ΣX = sum of Inventory management practice values

ΣY = sum profit values

ΣX^2 = sum of squared Inventory management practice values

ΣY^2 = sum of squared sum profit values

4.0 Result and Discussion

Findings from data analysis and hypotheses testing were displayed in tables below

Raw Material:- The results presented in Table 4.1 below of disaggregated regression and complementary t values indicated that inventory management practices influenced profitability of companies include; Raw materials which is significant for companies B, C and D. However, while we can expressly state that positive effect were experienced by companies B and C, the negative values for the regression and t test indicated a none positive effect of raw material on profitability for that company. However, positive values though none significant were also obtained for other three companies indicated a positive impact of inventory management on profitability of industry.

Work-in-progress:- Also, inventory management practice acted positively on companies A(a = 0.057; t = 3.85, G(b=0.711; t=2.11), however we can express that companies A, B, C and G had positive effect on work-in-progress, the negative value for the regression and t value in company E indicated a none positive effect of work-in-progress on profitability of the company.

Finished Goods:- Likewise, inventory practices showed positive impact on companies (b=0.133; t = -2.34; there was a reverse of negative value on companies A, B and C. However, had positive value despite none significant been obtained for companies E and G indicated a positive impact of inventory management on profit performance of medium scale food industries?

All the above findings were in tandem with the study of Diana, 2011 that there is a strong positive relationship between approaches of Inventory Control and Financial Performance at Pearson correlation coefficient. Inventory management is directly linked to production function of any organization and as such the inventory management system operated will affect the profitability of an organization directly and indirectly (Alm, 2000; Lambert, 2000; Diana, 2011).

Also findings were in line Lwiki, Ojera, Mugenda and Wachira 2013 that that there exists a positive correlation between inventory management and Return on Sales and also with Return on Equity. However findings were at variance with Olowolaju 2013 that found the application of inventory models, ratios, valuation and processing in arriving at sound decisions in SMEs to be generally very low.

4.1 How each Specific Inventory Management Practices affect Profit of Sampled Companies

SUMMARY STASTICS TABLE FOR THE SEVEN COMPANIES (DISAGGREGATED)

Comapanies	Coef of RAW M β	T	Coef of WIP β	T	Coef of FNSDGD β	T	P<0.05	
A	0.229	0.94	0.057	3.85	-0.035	-1.73		
B	0.036	2.11	0.073	1.90	-0.133	-2.34		
C	48.041	4.95	0.585	1.29	-2.407	-1.17		
D	-7.520	-4.82	0.981	0.18	7.412	1.35		
E	0.679	0.15	-0.215	0.24	0.631	0.40		
F	0.880	0.42	0.529	0.61	2.619	1.83		
G	-0.170	-0.05	0.711	2.11	1.098	0.64		

4.2 Relationship between inventory management practices and profit performance of selected medium scale food industry

The relationship between inventory management practices and profit performance of selected medium scale food industry was displayed in table 4.2 below.

Correlation: At 0.05 level of significant, correlation analysis showed that Raw materials, Work-in-progress and finished goods were significant to profit performance of selected medium scale food industry.

F-test:- Only finished goods are not significant at 0.05 level of significant as others. Reason, finished goods has little or no impact on production because they are goods waiting for distribution to distributors, wholesaler, retailer and finally to consumer. They were not used on the cost of production but end result of production; so, Raw Material, WIP, finished goods were significant t o profit performance of selected medium scale food industry. Therefore, pooled result showed the relationship of inventory management practices with the profit performance of selected medium scale food industry.

Table 4.2 Examine the relationship between inventory management practices and profit performance of selected medium scale food industry.

POOLED RESULT

	Correlation	**F-test @ 0.05**
ROCE VS RAM	0.833	2.609
WIP	0.911	6.552
Finished Goods	0.428	1.859

5.1 Conclusion

The evidence provided in this study based on the empirical findings, showed that inventory management has positive effect on profitability of food industry. Firms with abnormal high inventories have abnormal poor stock returns. On the other hand, firms with abnormal low inventories have ordinary stock returns. In addition, firms with slightly lower than average inventories perform best over time. Inventory management leads to inventory reduction, where raw materials and parts are purchased or produced just in time to be used at each stage of the production process.

5.2 Recommendation

Based on the findings made in the course of the study, the following recommendations are

hereby suggested:

i. Management of medium scale food companies should apply modern inventory models in order to maximize profit.
ii. Management of medium scale food companies should put into consideration inventory management when planning for better profit in the coming years and should also minimize the cost of production as lowest as possible.

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