The Relationship Between Cash Flow Management Practices and Perceived Business Performance : A Proposed Conceptual Model

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Abstract

The prime intention of this research paper was to create a conceptual framework to study the different dimensions of cash flow management practices and its linkages with cash flow forecasting practices and perceived business performance. The concepts of cash flow management, cash flow forecasting, and business performance made available the points to construct an integrated conceptual model, linking the aspects of cash flow management practices, cash flow forecasting practices, and perceived business performance. With the help of exhaustive literature review, it was found that variables relating to cash flow management practices were individually related to business performance. However, no model was found to investigate the combined influence of all the variables on business performance. Moreover, this paper proposed an indirect effect of CFM variables on business performance through cash flow forecasting practices, which is also a unique contribution of this paper. The four practices of CFM, (i.e., financing cash flow practices, operating cash flow practices, investment cash flow practices, and financial record keeping practices), cash flow forecasting, and perceived business performance were linked in a structured manner to examine their relationships. The current study will benefit the managers and owner managers in any enterprise to improve the business performance through cash flow forecasting practices and effective cash flow management practices.

Key words : **cash flow management (CFM) practices, cash flow estimation practices, perceived business performance**

JEL Classification : G3, L2, M4

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Entrepreneurs make sound business decisions about paying the suppliers, receiving from the customers, investing in an opportunity, looking for additional finance, reducing costs, and improving their value drivers through effective cash flow management practices. The process of monitoring, analyzing, and adjusting the business's cash flows is known cash flow management (Ward, 2018). A company's cash flow practices such as cash receivables, cash payments, and inventory holdings are related to improved firm performance (Stewart, 1995). When the cash flows become tougher to generate, the companies find it hard to secure additional finance (Rigby & Sweig, 2009). During recession, the companies having excess cash were able

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to acquire fragile competitors and grow faster (Dial, 2011). Processing of accounts receivable and accounts payable by means of centre of excellence, automating the cash management processes, adopting key performance indicators, and usage of technology are considered to be the best practices in cash flow management (Deloitte, n.d.). Awareness of cash flow management practices enables the business to generate income on additional reserves ; thereby increasing the profitability. Effective cash flow management is considered to be a performance improvement mechanism and lot of academic research has been conducted to relate cash flows and firm performance (Ebben & Johnson, 2011; Farris II & Hutchison, 2003; Kroes & Manikas, 2014). Ineffective cash flow management can debilitate a business by obstructing its capacity to finance planned investments or encumbering it with more interest costs and increased capital costs (Mccabe, Aggarwal, & Davis, 2012). Motive of holding cash, control of cash, cash held by the organization, and review of cash balance are used as variables for measuring cash management (Matadeen & Aukhorjee, 2014).

This research paper attempts to bridge the gap by the exploration of the relationship between cash flow management practices (CFM) and perceived business performance (PBP). Firstly, this paper intends to identify the cash flow management practices to evaluate the cash flow forecasting and business performance. Secondly, it attempts to propose a model to measure the impact of cash flow management practices on cash forecasting and perceived business performance. Thirdly, it aims to analyze which cash flow management practices are strongly related to cash flow forecasting and perceived business performance.

Review of Literature

(1) Financial Record Keeping Practices : The practice of keeping records is considered as important because without that, the business would not find out how to break even (Chelimo & Sopia, 2014). Controlling to create and develop the financial records to minimize the operating costs, optimize the productivity, accommodating novel technologies to handle financial records, and assuring compliance for regulatory aspects are considered as essential to set up record-keeping practices (Bebbington, Gray, & Laughlin, 2001). Effective record keeping furnishes evidence about the handling of the transactions, and it validates the steps taken to fulfil the regulatory norms. Well-timed decision making could improve performance of small businesses with the help of proper records keeping (Ezejiofor, Emmanuel, & Olise, 2014). Ineffective way of records keeping would make it tough to discriminate between the business transactions and the personal transactions. Managers and owner-managers are equally responsible not to use the business resources for their personal use at the cost of the business (Dawuda & Azeko, 2015). "Record management includes the application of organized and methodical control to all recorded evidence that a business wants to transact smoothly" (Bellardo & Bellardo, 1992, pp. 42 - 45).

(2) Operating Cash Flow Practices : "Operating cash flows concentrate on cash inflows and outflows related to a company's main business activities, such as selling and purchasing inventory, providing services, and paying salaries" (Investopedia, n.d. b., para. 1). The readiness of inventory would increase the performance of a company which thwarts a company from emergency buying (Chowdhury & Amin, 2007). The level of inventory enables the companies to increase the sales, which influence performance (Deloof, 2003). Companies can rescue themselves from price fluctuations by having a high level of inventory (Blinder & Maccini, 1991). However, some researchers opined that a company having a high level of inventory is said to have their money locked up which leads to a reduction in the performance (Autukaite & Molay, 2013). The surge in the level of debtors may also increase performance for the reason that it can aid as a quality assurance to customers (García - Teruel & Martínez-Solano, 2010 ; Pike & Cheng, 2001). To maintain an elongated relationship and increased performance, companies follow liberal credit policies (Wilner, 2000). Many of the research studies reveal the inverse relationship between average receivables and firm performance (Deloof, 2003; Martínez - Solano & García -

Teruel, 2007; Sivashanmugam & Krishnakumar, 2016). Accounts payable best practices provide companies with a robust sense of benchmarking with industry leaders and displays them by what means to take their services and processes to advanced levels (Schaeffer, n.d.).

(3) Financing Cash Flow Practices : The use of retained earnings are considered as internal financing, and the companies can acquire the external source of financing from capital markets, banking and non-banking institutions, etc. (Berger & Udell, 1998). Firms prefer retained earnings as these are easy and less risky sources of finance when compared to external sources of finance as these are harder to get and riskier. Hence, the order of preference would be retained earnings, borrowings, and equity (Cassar & Holmes, 2003). Mobilizing funds from floating of stocks and bonds are considered to be financing activities that result in an inflow of cash. Buyback of stocks, to pay off borrowings, interest payments, and dividends are considered to be financing activities that lead to an outflow of cash (Investopedia, n.d. a.). The proportion of bank loans to total debt identifies the bank as a key lender which shows a shortage of other finance sources available (Kumar & Rao, 2016).

(4) Investment Cash Flow Practices : Investing in fixed assets involves allocation of cash outflows to receive substantially significant cash inflows, which refers to the required payoffs in the time to come, over the valuable life of the invested fixed asset (Verma, Gupta, & Batra, 2009). Capital budgeting deals with cash flows for a definite period that tends to focus on specific projects, and it is concerned with accepting or rejecting a specific investment proposal (Hilton, 2008). Capital investment decisions should be properly adopted to make trade-offs between expected returns and risks that result in an effective firm performance. Capital budgeting is derived from the idea of making the best use of value for a firm that leads to value addition to the stockholders' with the help of capital investments (Hermes, Smid, & Yao, 2007). The theory of capital budgeting exists "at a crossroad in which the traditional quantification techniques have yet to be reconciled to the qualitative influences on the budgeting process" (Farazmand & Neill, 1996) .

(5) Cash Flow Forecasting Practices : "Estimate of the timing and amounts of cash inflows and outflows over a specific period is a cash flow forecast. A cash flow forecast shows if a firm needs to borrow, how much, when, and how it will repay the loan. It is also called cash flow budget or cash flow projection" (Business Dictionary, n.d., para. 1.). Cash flow forecasting is an instrument to manage cash, investments, and borrowings. Ineffective forecasts may form imprecise hedging volumes and necessitate more working capital than necessary. Cash forecasting improves a company's options to determine the capacity to generate future cash. Cash flow forecasting requires information from several things like accounts payables, accounts receivables, order systems, investment projects, taxes, payroll and bonus, budgets, loans, deposits, bank fees, rents, capex budgets, mergers and acquisitions, dividend, management fees, etc. (Lind, Bondéus, & Peer, n.d.). The cash budget is essential to confirm the adequacy of cash that is available always to fulfil the scale of operations drawn in the different budgets. Due to uncertainty, allowing for a margin of error concerning planning, it is essential to provide more than the lowest requirement of cash.

(6) Perceived Business Performance : Business performance is one of the essential elements of empirical research, which is used as a commonly used final dependent variable construct. Higher the financial performance, the more satisfied the investors would be (Chakravarthy, 1986), which represents profitability, growth, and a firm's market value (Cho & Pucik, 2005 ; Deng & Dart, 1994 ; Forker, Vickery, & Droge, 1996 ; Narver & Slater, 1990; Venkatraman & Ramanujam, 1986). The objective and subjective measures of financial performance have a significant positive correlation (Dess & Robinson, 1984). The firm's subjective performance scores are captured by rating the scale like "very poor" to "very good," or "much lower" to "much higher" as compared to rivals

(Dawes, 1999). The objective performance measures are convenient to a lesser extent for measuring non-financial aspects and comparing between firms (Forker et al., 1996 ; Slater & Olson, 2000 ; Wiklund & Shepherd, 2003). Researchers can employ subjective measures to ask respondents to compare the performance metrics concerning a standard (Santos & Brito, 2012).

Proposition Development

(1) Relationship Between Financial Records' Maintaining Practices and Perceived Business Performance : Accounting is an inseparable part of the economic and social system. It facilitates the management in decision-making process (Muhindo, Mzuza, & Zhou, 2014). Amoako (2013) revealed that majority of the SMEs did not maintain a detailed accounting system as it would expose their financial position. Unscientific practices of accounting and record keeping coupled with improper fund managing skills are considered as the vital causes for SMEs' failure. Most of the entrepreneurs of SMEs are not even literate to distinguish between revenue and profit, while some of them do not have the knowledge to distinguish gross profit from net profit. The study further revealed that owners were not even aware whether the business was running at profit or loss (Ademola, Olaleye, Olusuyi, & Edun, 2013). Muhindo et al. (2014) conducted a study in Uganda, which revealed that the business performance of most of the small-scale businesses was consistently at a lower level due to lack of accounting information systems. Mutua (2015) conducted a study with 120 respondents and observed that inadequate knowledge in accounting and unaffordability to hire accounting professionals were the major reasons for incomplete records of accounting, which eventually led to an inability to measure the financial performance of SMEs. Chelimo and Sopia (2014) found that the double entry system of bookkeeping was followed in maintaining the financial records. The paper also revealed that the growth of SMEs and their profitability had a positive relationship with proper book keeping. Abdul - Rahamon and Adejare (2014) found that financial record keeping and business performance had a strong positive relationship with small - scale enterprises. Musah and Ibrahim (2014) observed that the bookkeeping practices and firm performance had a positive relationship. Ezejiofor et al. (2014) found that record keeping practices of SMEs had an impact on business performance. The findings of Muhindo et al. (2014) revealed that the level of profitability of SMEs and accounting information system had a positive relationship. Thus, the following proposition is proposed:

- **P1: Financial record keeping practices are positively associated with perceived business performance.**

(2) Relationship Between Cash Flow Forecasting Practices and Perceived Business Performance : Cash flow forecasting is regarded as a significant and persistent managerial exercise (Glaum, Schmidt, & Schnürer, 2015). Small firms' financial performance is significantly influenced by their cash flows (Lowell, Sharon, & Wayne, 1989). Cash flow forecasting may help reduce risk, avoid liquidity crises, and guide for company operations (Jagers & Umbreit, 2014). Financial and economic crisis in the past have always emphasized the requirements of proper financial planning and forecasting of cash flows (Campello, Giambona, Graham, & Harvey, 2009). Forecasting of cash flows is considered as essential for the success of working capital management (Kroes & Manikas, 2014). Budgeting has been described to be significant and fundamental to business financial performance (Akande & Oluwaseun, 2014). Managers tend to produce goods in large quantities to achieve the economies of scale which would result in minor cash inflows in the present period despite the benefit of higher earnings (Roychowdhury, 2006). With the help of cash flows forecast, companies would be less likely to overproduce because of its detrimental effect on cash flows. Firms which barely meet analysts' cash flows forecast are less likely to engage in overproduction (Zhang, 2009). Budgeting has been described to be a significant and basic requirement for business financial performance results, which shows a substantial relationship between

budgeting practices and SMEs' financial performance (Akande & Oluwaseun, 2014). Thus, the following proposition is proposed :

✦ **P2: Cashflow forecasting practices are positively associated with perceived business performance.**

(3) Relationship Between Cash Flow Practices and Cash Flow Forecasting Practices : Lazaridis (2002) found that an elaborate cash flow forecast was required for all types of investments and also the items like taxes, depreciation practices, receipt and payment of funds, revenue forecast, and operating costs were considered for the quantitative forecast to improve their estimates. Buertey and Kumi (2012) conducted a study and found 15 significant factors like a discount on stock purchase, interval between cost obligation, legal obligations, overhead expenses, advance payment, etc. affecting the cash flows. Farshadfar, Ng, and Brimble (2008) found that operating cash flows significantly influenced the upcoming cash flows. Also, the predictive ability of operating cash flows increased with firm size. Nevertheless, the power of cash flow from operations was strong across small, medium, and large firms in forecasting the future cash flows. Shorter-term estimates employed accounts receivable and payable or daily cash flow monitoring. Forecasting approaches such as econometric models, trend extrapolation, and computer-based planning depends upon the cost of variances, reliability requirements, and sensitivity to error (Knight, 1982). Short-term forecasting can be done by tracking customers' payment practices, and long-term forecasting can be done by software programs by integrating various department data. The technique of accrual add-back that computes working capital changes can be used for intermediate-term forecasting (Gage, 1990). Thus, the following proposition is proposed:

✦ **P3: Cash flow practices are positively associated with cash flow forecasting practices.**

(4) Relationship Between Operating Cash Flow Practices and Perceived Business Performance : Financial performance of small scale enterprises is greatly influenced by the working capital management practices (Nyamao, Patrick, Martin, Odondo, & Simeyo, 2012). Ismael and Muhamed (2013) found that there existed an inverse relationship between working capital and perceived market share. "SSEs financial performance was positively related to the efficiency of cash management (ECM), the efficiency of receivables management (ERM), and efficiency of inventory management (EIM)" (Nyamao et al., 2012, p. 5807). Karadag (2013) found that strategic working capital management had a direct relationship with SMEs' performance. Afrifa, Tauringana,and Tingbani (2014) observed that SMEs' profitability depended on effective cash conversion cycle management. Another study revealed that the days payable outstanding had a significant positive relationship with profitability of the firms (Selvanayaki, Sivakumar, & Mahendran, 2015). Thus, the following proposition is proposed:

✦ **P4: Operating cash flow practices are positively associated with perceived business performance.**

(5) Relationship Between Investment Cash Flow Practices and Perceived Business Performance : Fatoki (2012) found that new micro-enterprises did not engage in financial analysis and investment appraisal. Grazzi, Jacoby, Treibich, Superiore, and Anna (2011) found that there existed a short term inverse relationship between investment spikes and productivity growth. Though, concentration on lengthier dynamics would result in a positive effect, thereby confirming the hypothesis of learning curve. The level of corporate performance had an inverse relationship with the level of sophistication of investment planning (Pike,1984). Farragher, Kleiman, and Sahu (2001) found that there was no apparent relationship between capital budgeting sophistication and corporate performance. The change in investment behavior of the firms led to improvement in operating performance and growth opportunities with respect to their own previous performance (Hogan & Lewis, 2005).

Thus, the following proposition is proposed:

✦ **P5: Investment cash flow practices are positively associated with perceived business performance.**

(6) Relationship Between Financing Cash Flow Practices and Perceived Business Performance : Firm performance in terms of profitability has an inverse relationship. High debt ratio increases the agency cost and would result in loss of control for the firm. SME managers and owner managers finance their businesses with a reasonably high degree of owners' equity, thereby focusing on a optimum level of debt in the total capital requirements (Yazdanfar & Öhman, 2015). The results of another study conducted to measure firm efficiency suggested that ownership structure and leverage had a positive relationship between them (Akhtar, Zahir, Tareq, & Rabbi, 2016). Financial performance of state-owned corporations had a negative relationship with debt financing (Nyamita & Garbharran, 2014). Subsidiary firm performance had a positive relationship with the decision making that involved internal equity financing (Nguyen & Rugman, 2014). Small and young entrepreneurs were likely to get finance from venture capital and private equity funds, which is evident in their business performance (Capizzi, Giovannini, & Pesic, 2011). Another study revealed that leverage had a significant influence on profitability (Vijayalakshmi & Manoharan, 2014). Thus, the following proposition is proposed:

✦ **P6: Financing cash flow practices are positively associated with perceived business performance.**

Conceptual Research Framework

The literature review makes available the basis for the setting up of a conceptual research framework to study the impact of cash flow management practices on cash flow forecasting practices and perceived business performance. The proposed model shows the direct effect of cash flow management practices on perceived business performance and the indirect effect of cash flow management practices on perceived business performance through cash flow forecasting practices. The proposed model portrays a new way of understanding for enterprises that practice CFM to be cognizant of the significant impact of CFM practices on cash flow forecasting practices and perceived business performance. It is proposed in the model that higher cash flow forecasting practices, and higher perceived business performance will exist in an enterprise where cash flow management practices are carried out in an effective manner (Figure 1).

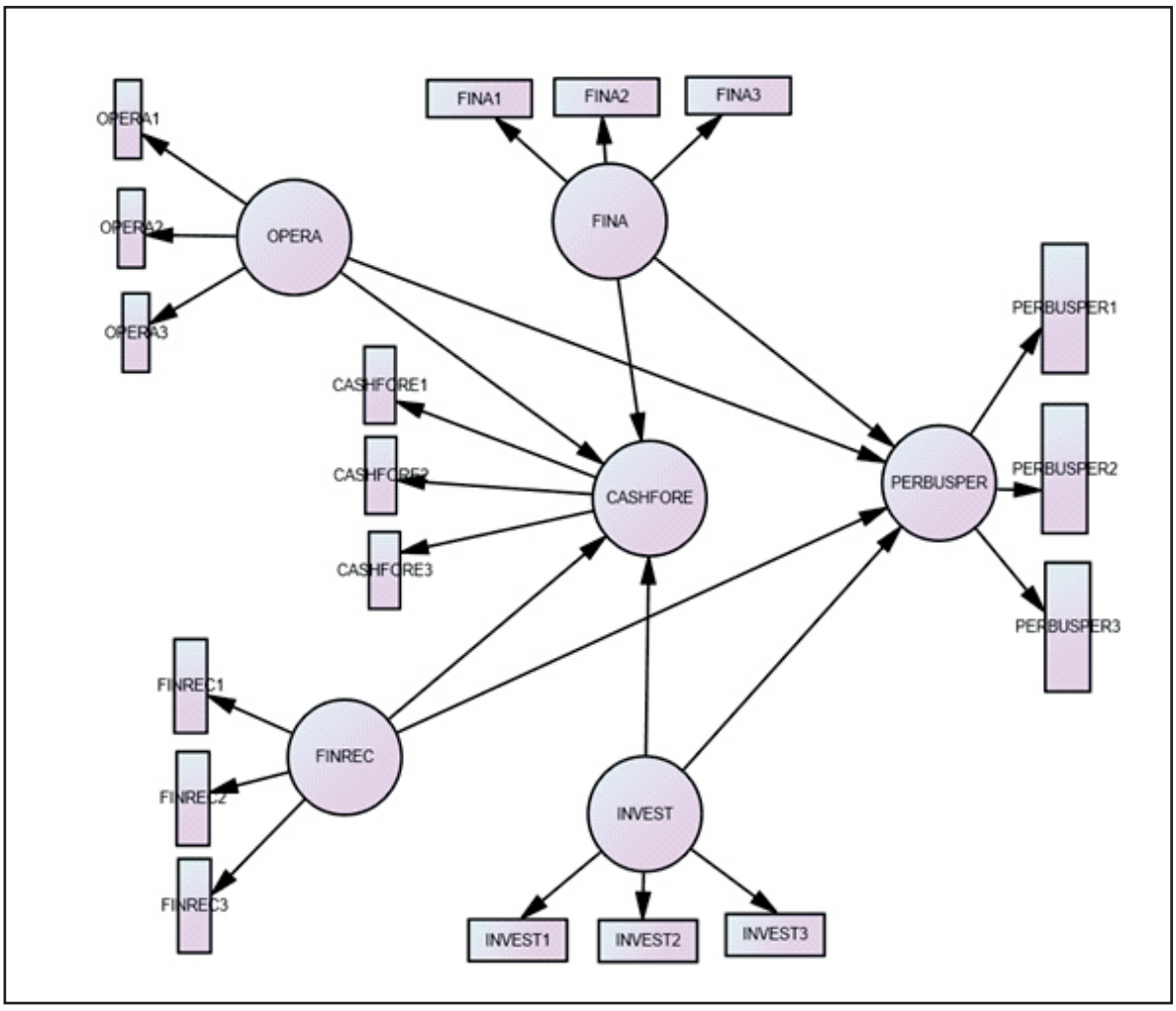
Theoretical Implications

The current study has a valuable contribution in the cash flow management practices literature by furnishing a better apprehension of the effects of cash flow management practices on improving the company's options to determine the capacity to generate future cash, specifically, cash flow forecasting practices and perceived business performance. The current study tries to stretch the literature available in this field. Thus, the conceptual model figures a theoretical basis to figure out the association that exists between the variables. This would enable the enterprises to focus on the CFM practices that bring improvement in the performance of firms.

Limitations of the Study

All effort was made to examine the review of literature and designing of the model with proper understanding of different entities and relationships to obtain a more reliable and testable base model. However, some limitations of

Figure 1. Proposed Model for Cash Flow Management Practices and Perceived Business Performance



FINA = Financing Cash Flow Practices; *CASHFORE* = Cash Forecasting; *OPERA* = Operating Cash Flow Practices; *INVEST* = Investment Cash Flow Practices; *FINREC* = Financial Record Keeping Practices; *PERBUSPER* = Perceived Business Performance

this study ought to be discussed in this section. There might be fewer surprises down the road where any other entities and relationships might have been neglected or forgotten. It may be a challenging task to deploy the model in order to practice it when the size of the organization and issues relating to complex projects increases.

Conclusion and Scope for Further Research

The study contributes valuable insights into the CFM literature field by showing the structural relationship between CFM practices, cash flow forecasting practices, and perceived business performance. Even though CFM practices have a significant influence on the performance of a business, relatively fewer attempts have been made to study the relationship between CFM practices, cash flow forecasting practices, and perceived business performance. Thus, the current study intends to construct a conceptual model for the use of CFM practices in measuring cash flow forecasting and perceived business performance. The current study proposes a model to

analyze the extent to which financing cash flow practices, operating cash flow practices, investment cash flow practices, and financial record keeping practices help to effectively forecast the cash flows of an enterprise, thus increasing the performance of a business. It is expected that effective cash flow management practices would pave the way for an enterprise to forecast the cash flows in an effective manner, thereby increasing the performance of an enterprise. The current study is an initial attempt to study the relationship between CFM practices, cash flow forecasting, and perceived business performance. The present study leaves scope for further investigation of any other entities and the relationships existing among them. Furthermore, this study also leaves scope for the development of scale for data collection. In order to test and validate the base model, an empirical research may be conducted using a structured questionnaire.

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