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Net Working Capital Management Strategies in the Construction Enterprises Listed on the NewConnect Market

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Abstract

The purpose of this article is to identify the Net Working Capital (NWC) management strategies in enterprises operating in the construction sector quoted on the alternative exchange market NewConnect, regarded as one of the most positively differentiating among similar markets in Europe. The article shows the concept of identifying NWC management strategies. On the basis of the developed methodology, the types and the number of the management strategies applied by the examined companies were specified. The study covered 2009–2014, i.e. the period of the most severe economic crisis since the fourth decade of the twentieth century.

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Keywords: net working capital; strategies of the net working capital management; construction sector

1. Introduction

Started in 2007, the global economic crisis has not left the Polish companies without an impact, including those belonging to the construction sector. In the years 2008–2013, companies in this sector recorded a deterioration of many financial indicators, including, inter alia, decline in the net profit per 1 company, decline in profitability (ROS, ROA, ROE). Analysis of statistical data shows, however, that other indicators, such as liquidity rates, have not been subject to significant changes in this period and remained at an optimal level (1–8), (Table 1).

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Table 1. The selected data characterizing the financial situation of the companies of the construction section in the years 2007-2014.

Description	2007	2008	2009	2010	2011	2012	2013	2014
Net financial result per 1 company (PLN mln)	1.6	1.4	1.4	1.2	0.9	0.2	0.5	1.0
Current ratio	1.68	1.63	1.72	1.74	1.57	1.54	1.56	1.57
Quick ratio	1.22	1.20	1.15	1.19	1.04	1.01	1.06	1.09
Return on sales – ROS (%)	6.6	5.9	6.1	5.1	3.2	1.0	2.1	3.8
Return on assets – ROA (%)	27.2	22.2	14.7	15.3	11.6	3.3	6.4	12.2
Return on equity – ROE (%)	9.4	8.0	6.2	5.7	3.9	1.1	2.1	4.0
Debt ratio	0.65	0.64	0.58	0.62	0.66	0.67	0.67	0.67

A significant impact on the maintenance of an appropriate level of liquidity is net working capital (NWC), which consists of current assets and current liabilities. The way to manage NWC depends on the strategy employed in the enterprise. The question then arises: What NWC management strategies were employed by the Polish companies operating in the construction sector during the global crisis?

The article aims to identify the net working capital (NWC) management strategies in enterprises operating in the construction sector listed on the NewConnect market. It discusses the concept of working capital and presents strategies for managing net working capital. The paper also presents the methodology to identify the implemented strategy of net working capital management. Subsequently, the types of NWC management strategies used by the surveyed companies have been determined on the base of the presented methodology. The study covered the period from 2009 to 2014, i.e. the time when the economic crisis in Poland took place.

The first global crisis' symptoms in Poland could be noticed in the second half of 2008. This is why, in this study, 2009 was assumed to be the first full year in which the surveyed companies were forced to operate under the conditions of the global crisis. Then, due to lack of statistical data for the year 2015, the last analyzed period was assumed to be 2014 (According to the Report 2015 of the experts from the Goldman Sachs Investment Bank, the crisis that began in 2008 still has not come to an end).

2. Categories of net working capital

In the subject literature, the concept of working capital is not clearly understood. The most common, however, are two concepts relating to working capital: gross working capital and net working capital. The former is associated with current assets that constitute the total amount of circulating capital owned by the company [9, 10]. The latter, meanwhile, is defined as the difference between [11]: the size of current assets and current liabilities (property approach), capital employed (sum of long-term sources of financing assets) and fixed assets (equity approach).

The property approach is also known as short-term approach, while the equity approach – as long-term approach. Net working capital can be either positive, negative or neutral (i.e. assume value zero), at least in theory.

Positive NWC occurs when part of the current assets is financed by long-term capital. Positive NWC means that the company has an operational buffer in the form of appropriate reserve funds, which will allow it safe operation during the period between paying the liabilities and charging the receivables. The higher the NWC, the safer the company's conditions for financing its business operation. The increase in positive NWC, however, involves the increase in the weighted average cost of capital (WACC). This is because the cost of servicing long-term capital gets higher, which requires incurring higher interest costs than in the case of short-term capital.

Negative NWC occurs when fixed assets are financed partly by short-term capital. This solution is less expensive than positive NWC since the average cost of capital is actually lower, but this option is also more risky – the company has no buffer understood as an adequate supply of resources that could facilitate its operation in the period between paying the liabilities and charging the receivables.

Neutral NWC occurs when current assets are equal to short-term liabilities. In such situation, there is no constant capital that would finance the assets. Still, this scenario is for the most part theoretical [11].

NWC level depends on the strategy chosen by the people managing the company.

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