Chapter 8

Privatised Firms

8.1. Introduction

In chapters 6 and 7 we assessed the management of working capital levels and operations of the government and the transition firms. In this chapter we continue with regard to the privatised firms. We study how three privatised firms - Asmara Milk Factory, Asmara Sweater Factory and Eritrean Steel Sheet Factory manage their internal and external working capital levels and operations. We particularly concentrate on Asmara Milk Factory’s internal working capital management, its suppliers co-operation with University of Asmara, - Department of Animal Sciences or (DAS) and its customer co-operation with Berhane Frafre. We have selected Asmara Milk Factory because it represents a typical privatised firm whose supplier and customer responses we have included in our study. A comparison is also made between that of Asmara Milk Factory and the other privatised firms.

Our objective in this chapter is to answer question (2c) of the research study: “How do privatised manufacturing firms in Eritrea manage their internal and external working capital”? Section 8.1 introduces the chapter and section 8.2 presents the firm’s overall working capital management issues. Section 8.3 covers the internal management of working capital levels and operations. Section 8.4 deals with the external working capital management, including firm-supplier linkages (8.4.1) and firm-customer linkages (8.4.2). Section 8.5 concludes the chapter.

8.2. Overall working capital management

This section presents Asmara Milk Factory’s overall working capital management issues, including its historical background, organisational structure, objectives of working capital management and constraints to achieve the objectives as well as the role of working capital management in creating value. We start with a background information on Asmara Milk Factory (section 8.2.1) and then present a comparative analysis of the privatised (section 8.2.2). For detailed information on overall working capital management issues, refer to Appendix 8.1.

8.2.1. Background information

Historical background of the firm Asmara Milk Factory initially started as co-operative business whose members were dealing in the production of milk and milk products. The co-operative members were selling their milk production to the factory. The factory continued its operation in its original form until 1974 when it was nationalised by the Ethiopian Government. At independence, the Eritrean government continued administering the factory as a government firm until July 1999. As result of the government’s privatisation policy, Asmara Milk Factory was privatised in August 1999. Among others, Asmara Sweater Factory and Eritrean Steel Sheet Factory were also privatised in May 1998 and in April 1998 respectively. Asmara Milk Factory is sold to its suppliers [about 500 to 600 in number], who own and manage it as a co-operative. The firm’s general management does not have information on the original
capital of the firm. It has not changed its original operations, which is still to process and sell milk and milk products. According to the general manager, the factory is making capital investments and will start producing additional milk products like Yoghurt and Cheese within few months. It has also a plan to computerise its information processing and record keeping activities in the near future.

**Organisational structure** Its organisational structure includes the owners, the general manager (who also serves as a commercial manager) and a financial manager. According to the general manager’s opinion, he is fully empowered to make decisions regarding working capital levels of investments and financing, as well as operations of production, purchasing and sales. As a marketing manager he is also responsible to investigate and assess the market and apply an appropriate marketing strategy. The financial manager controls the firm’s financial operations and reports to the general manager periodically. The general manager reports to the owners’ annual general meeting.

**Firm policies and constraints** According to the opinion of the firm’s financial manager, the main objectives of working capital management include the increase of sales, the decrease of costs and to generate profit but not to remain liquid. The firm manages its working capital in such away that it buys its materials on credit and sells its goods to larger customers on a monthly credit basis and uses cash collected from operations to finance its working capital investments and daily activities. It pays its suppliers and collects from customers in the first 10 days following the months of purchases and sales. It does not keep raw materials and finished goods inventory in the store because production starts immediately when the materials are received and the sales is directly after production. Milk is received at the beginning of a day processed and sold in that same day. The firm has a policy of generating income enough to cover current operations and earn a decent profit margin with the current lines of production. During the interview conducted with the firm’s general manager, he said that: “Our short-term objective is to maintain the current production and sales capacity. While in the long-term, we have a plan (in co-operation with an Italian firm) to diversify our products and invest in the production of cheese, yoghurt, ice cream, mixed juice of milk and orange and other milk products”. The financial manager believes that the factors that determine working capital levels include mostly sales growth and operating efficiency. However, price levels of inputs, credit policy and availability of credit do not influence the levels of working capital.

On the constraints in achieving short and long-term objectives the manager said that: “We have no constraint to achieve short-term objectives at all. However, how efficiently we achieve our long-term objectives will depend on the availability of capital and the agreement of firm-owners on the partnership with the Italian firm”. According to the general manager, the factors that hinder the firm from achieving its objectives are fixed capital investment and financing. However, production capacity and markets are not problems. According to the opinion of the general manager, there are no government regulations that affect management’s decisions. However, there are cultural issues, which seriously affect the sales of the firm’s products. The two religions strictly followed in Eritrea are Christianity and Islam, which require their followers to have at least one-month fasting per year. During the months of April and May, most Christians fast and do no take milk, milk products and meat. During the month of December, Moslems do not take any food during the daytime when the
businesses are open. They start taking food in the evenings but by then businesses are
closed. So, the firm’s sales considerably decrease during this fasting periods. As a
solution, during these fasting months the firm produces milk products such as butter
that can be stored for a later use.

**The role of working capital management on value creation** On the role of working
capital management in promoting the firm’s objectives on value creation, the general
manager said that: “Managing working capital investments and short-term financing
has a major role to play in promoting our short and long-term objectives. Our
planned capacity expansion and product diversification will depend on how
successfully we performed the current working capital investments and financing
because future success can only be an extension of current success”. The firm’s
financial manager also believes that overall working capital management has a pivotal
role to play in value creation, particularly in increasing sales and decreasing costs of
purchases, production and inventory. He believes that managing cash, receivables,
inventory, purchase of materials and trade payables can achieve these objectives.

8.2.2. Overall working capital management issues - comparison of privatised firms

Here we try to study if the three privatised firms reveal similarity or have a material
difference on the overall working capital management, particularly the policy of
working capital management, the constraints in achieving firm objectives and the
factors determining firm objectives. For detailed information on the overall working
capital management issues, see Appendix 8.1.

**Firm policies and constraints** The financial managers of the privatised firms
responded that their working capital management policy is tailored towards increasing
sales, decreasing costs and thereby generating profit but only Eritrean Steel Sheet
Factory responded that it also aims at remaining liquid. On the constraints in achieving
firm objectives, the managers of Asmara Milk Factory and Asmara Sweater Factory
believe that the factors, which are constraining firm objectives, include working capital
investment and financing as well as fixed capital investment and financing. Asmara
Sweater Factory also has a lack of production capacity, labour availability, product
demand and markets. The manager of Eritrean Steel Sheet Factory did not give an
opinion on the firm’s constraints to achieve objectives.

**The role of working capital management in value creation** Financial managers of
Asmara Milk Factory and Eritrean Steel Sheet Factory believe that working capital
management has an important role in value creation. The managers’ response denote
that working capital management is important for the purpose of increasing sales by
managing cash, trade receivables, inventory, trade payable, sales of finished goods and
purchase of materials. They also believe that working capital management can be used to
derease costs by managing purchase of materials, inventory, cash and receivables, but
not payables, bank loans or liquidity.
Chapter 8

8.3. Internal working capital management

This section covers Asmara Milk Factory’s internal working capital management, which is divided into levels of investment (8.3.1.) and financing (8.3.2.) as well as operations of purchasing (8.3.3.) and selling (8.3.4).

8.3.1. Managing working capital investments

In this section we discuss the managers responses to questions on how the privatised firms manage working capital investments of cash, receivables and inventories. The objective is to find out if Asmara Milk Factory and the other two-privatised firms apply value-creating methods of managing working capital levels of investment. First, we consider Asmara Milk Factory then compare it with the other privatised firms.

8.3.1.1. Cash management

In this section we examine if Asmara Milk Factory and the other privatised firms create value by managing cash balances, collections and payments. Therefore, we asked the managers on their motive for holding certain balances of cash levels, purposes and approaches of forecasting cash, on preparing cash flow statements as well as controlling cash payments and collections. For detailed information on Asmara Milk Factory’s cash management, refer to Appendix 8.2.1.1.

The motives for holding cash

According to the firm’s financial manager, the main purpose for holding cash in the firm is for transaction purposes - to make regular predetermined payments. The firm rarely keeps any cash for making unforeseen investment opportunity (speculative purpose) and it does not keep cash to pay for unforeseen transactions (precautionary purpose) or as a guarantee for bank loans.

Cash budgeting and control

The factory’s management prepares cash budgets mainly to plan for short and long-term cash needs, to control liquidity, cash payments and receipts. The primary bases used to forecast the cash budget are past experience, opinion of the management and forecasted sales levels. Asmara Milk Factory prepares cash flow statements using the receipts and disbursements method, which it uses to improve its future cash forecasts as well as to control cash payments and receipts.

Managing cash payments and collections

The firm has a petty cash fund with a maximum balance of Nakfa 4000. It uses this petty cash fund to pay for expenses less than Nakfa 500, payments above this amount are made using checks approved by the general and financial managers. Collections from lager customers (from the point of sales volume) are made mostly using customer checks. However, cash from the smaller shops is collected by the firm’s door to door sales persons and is deposited in the bank on a daily basis. The firm purchases only on credit without discount, which it considers as a policy of slowing-down cash payments and the cash sales to smaller customers is considered as a means of speeding-up the cash collection. The factory controls its cash payments using a petty cash system, voucher system, using checks sequentially numbered, which are controlled and accounted regularly and preparing
bank reconciliation by employees other than those involved in cash collections and payments. It controls cash collections by separating duties for sequential cash operations, handling and recording.

**Concluding remarks** Asmara Milk Factory makes little use of its bank overdraft facilities because it generates enough surplus cash from its operations. Partially it uses its cash surplus to pay for the debt borrowed when the firm was privatised and what remains is deposited at its bank’s checking account to pay for day to day working capital operations. It has a minimum cash balance for transaction purposes including the petty cash fund, which it uses for small payments. We observe that the firm management is fully empowered to manage the cash affairs of the firm but makes no use of its managerial empowerment because of the lack of investment opportunities. However, according to the general manager, there is a plan to invest its surplus cash in machinery that it will use to diversify products.

### 8.3.1.2. Inventory management

The objective of this section is to study if Asmara Milk Factory creates value by managing its materials and finished goods inventory balances. Therefore, we asked the managers if and how they determine inventory costs and values, formulate and implement inventory forecasting and control (physical and cost) approaches. For detailed information on inventory management, refer to Appendix 8.2.1.2.1 -materials inventory management and 8.2.1.2.2 - finished goods inventory management. For detailed information on Asmara Milk Factory’s inventory management, refer to Appendix 8.2.1.2.1 (materials inventory) and Appendix 8.2.2.2 (for finished goods inventory).

**Materials inventory management** According to Asmara Milk Factory’s financial manager, the firm’s materials inventory is mostly raw milk or plastic cases, which are used to pack the processed milk. The plastic cases are imported once in six months, which the financial manager says that it takes little space and is not perishable. Asmara Milk Factory’s main objective in managing these inventories of materials is to reduce holding and ordering costs as well as to safeguard against shortages and to keep the production running. The firm’s major cost of holding inventory of materials is the costs of handling, and record keeping. The cost of physical deterioration, obsolescence, shrinkage, depreciation and pilferage costs, the opportunity cost of capital invested or interest on capital tied-up, security and power are very small.

The firm minimises materials holding and ordering costs using the “just-in-time” approach of inventory management and tries to keep only the minimum required. It is also minimised by agreeing with the suppliers so that they bring their daily milk production only from 6 am to 10 am, after which the firm stops accepting for that day. Management uses this system mainly due to the problem of storage capacity. The firm cannot continue production throughout the day because supply is very small, so it accumulates incoming supply by limiting the time it purchases materials. The suppliers bring to the factory any amount of milk that they can produce. Ordering costs are minimised by making a contract agreement only once. The factory uses the average cost approach to determine the cost of materials issued to production and remaining in inventory and these inventories are valued in the balance sheet as such.
**Finished goods inventory** According to the financial manager, the firm produces only one type of product - pasteurised milk. The production process takes only half a day, so there is no work-in-process in the factory.

The cost of holding inventory of finished goods include, mainly the cost of physical deterioration. Other costs such as power, insurance, property tax, handling, security, and clerical record keeping are considered to be small. Finished goods inventory is valued on the basis of average cost. According to the firms general and financial managers the factory minimises finished goods holding and ordering costs using the “just-in-time” approach of inventory management. Holding costs of finished goods inventory is minimised by agreeing with customers for the firm to use its own transportation to take the goods to the place of its customers on a daily basis. Ordering costs are minimised by making a contract agreement only once, where its customers indicate the supply of milk that they want on a daily basis. Asmara Milk Factory uses the average cost approach to determine the cost and value of cost of goods sold and remaining in inventory.

**Concluding remark** Asmara Milk Factory manages its materials and finished goods inventory such that the ordering and carrying costs are minimised. The bottleneck for the firm is the lack of supply of milk. As a result of this its production capacity is utilised only to the extent of 50%. In order to solve this problem the firm’s management is planning to diversity its production in the short-term to other types of products which have a higher profit margin. Therefore, we could conclude that Asmara Milk Factory’s materials and finished goods inventory management has contributed positively to the profit, the net cash flows and the liquidity position.

**8.3.1.3. Receivables management**

In this section we try to study if Asmara Milk Factory creates value by managing receivables. Therefore, we asked the firm’s financial manager if and how management formulates its policies of accounts receivable management, how it controls its credit collection and the costs of accounts receivables and bad debts. For detailed information on Asmara Milk Factory’s receivables management, refer to Appendix 8.2.1.3.

**Credit policy and receivables management** Asmara Milk Factory sells to larger customers on the basis of a monthly credit without discounts and these customers generally pay within the first 10 days of the month after sales. However, the financial manager believes that the firm does not have problem of managing receivables. The main source of information for screening credit applicants is the size of the customer’s proposed purchase and the firm’s prior experience with the customer. Customers who order large daily purchases are preferred for credit sales. The applicant’s financial statements, visits to the customer, personal contact with the applicant’s banks and other creditors, credit reports on the customer’s payment history with other firms are not used at all as a source of information for screening credit applicants. The firm uses an open account with no discount for those who buy on credit. However, it does not use credits with discount, promissory note or seasonal dating. The 5 C’s (capital, character, collateral, capacity, conditions) are used to evaluate any future credit application. In
order to collect overdue receivables the firm makes telephone calls and extends credit periods. However, it never employs a collection agent or take legal action. It rarely sends a reminder (or delinquency letter) nor makes personal visit in order to collect overdue receivables. If the level of receivables is too high the firm does not have a control mechanism.

### 8.3.1.4. Managing working capital investment - comparison of privatised firms

Here we want to know if the privatised firms reveal similarities or differences in managing their working capital levels of investment, particularly cash, inventories and receivables. For more supporting information on the privatised firms’ comparative management of working capital investment, refer to Appendix 8.2.1.1 (cash management), Appendix 8.2.1.2 (inventory management) and Appendix 8.2.1.3 (receivables management).

**Cash management** The purpose of cash planning for all the privatised firms is the transaction purpose of making regular pre-determined payments. The financial manager of Eritrean Steel Sheet Factory also reported that the firm’s cash management has the objective of speculation and precaution. The other two privatised firms reported that they do not manage cash for the purposes of speculative or precautionary reasons mainly because they have no opportunity to make cash investments with a profit motive. It is only Asmara Milk Factory that forecasts cash in order to control cash payments, collections and levels as well as to plan short-term and long-term cash needs using past experience, management opinion and forecasted sales as bases. The other two privatised firms do not forecast cash requirements and do not make hedges against cash shortages because the bank provides overdraft if they need it. However, all firms prepare cash flow statements by using the receipts and disbursements approach and they use it to control cash payments and collections. Only Asmara Milk Factory experiences cash surpluses that it deposits at its bank checking account. Asmara Sweater Factory and Eritrean Steel Sheet Factory are experiencing cash deficits which they finance using short-term bank borrowings and overdraft. They control cash payments by using a voucher system, checks, bank reconciliation, and a petty cash system. Asmara Sweater Factory and Eritrean Steel Sheet Factory collect cash at or in advance of sales while Asmara Milk Factory collects cash at sales and in the ten days after the month of sale. The firms consider the cash sale as means of speeding-up cash collection, which they control by separating duties for sequential cash operations and depositing cash at the bank on a daily basis.

**Materials inventory management** Materials inventory policy of all three privatised firms is tailored strongly towards minimising inventory holding and ordering costs as well as safeguarding against inventory shortages and to keep production running. They apply inventory management approaches like holding the minimum level required, just in time and economic order quantity (except Asmara Milk Factory). They all selectively control the physical safety of their materials inventory on the basis of average cost and usage rate. Asmara Sweater Factory and Eritrean Steel Sheet Factory also control on the basis of scarcity in the market. While Eritrean Steel Sheet Factory also uses criticality in case of shortage. They use only the average cost technique to determine the value and cost of materials used in production and left in the inventory. For Asmara Sweater Factory and Eritrean Steel Sheet Factory the opportunity costs of capital invested in the
materials inventory and the costs of insurance are considered relevant costs of materials inventory. Moreover, Asmara Sweater Factory and Asmara Milk Factory reported that the cost of handling materials is large enough to deserve managerial attention. However, the overall cost of material inventory management is not relevant with all the firms.

**Finished goods inventory management** The financial managers of all three privatised firms reported that they hold finished goods inventory to satisfy regular customer demands, to meet high seasonal demands and to keep safety stock (except Asmara Sweater Factory). None of them manages finished goods inventory to decrease inventory holding costs, while Eritrean Steel Sheet Factory holds it to take advantage of economies of scale. For Asmara Sweater Factory and Eritrean Steel Sheet Factory the opportunity costs of capital invested in the materials inventory and the costs of insurance are considered relevant costs of finished goods inventory. The privatised firms, except Asmara Milk Factory use only the technique of holding the minimum level required in managing the costs of holding finished goods inventory. All three privatised firms selectively control the physical safety of the finished goods on the basis of costs while Asmara Milk Factory and Eritrean Steel Sheet Factory use the usage rate too. On the issue of inventory costing and valuation they all use the average cost technique to determine the costs and value of finished goods sold and in inventory.

**Receivables management** The privatised firms have different sales policies depending on whether the customer is large or small and a government firm or a private firm. The cash sales refer to smaller private firms while the credit sales refer to larger private and all government firms. With regard to their private credit customers they apply credit standards based on a repeat sale approach while Eritrean Steel Sheet Factory and Asmara Milk Factory also use the five C’s (capital, character, collateral, capacity and conditions). In order to collect overdue receivables they all make telephone calls and extend credit periods, but it is only Asmara Sweater Factory, which makes personal visits and none of them employs collection agents or takes legal action. However, the risk of bad debt is very low and none of them makes allowances for it.

8.3.2. Managing working capital finances

**Sources, costs and influences of working capital financing** Asmara Milk Factory uses the cash earned from operations and deposited in its bank’s current account as a source of working capital financing. The response of the general manager indicated that, the firm’s cash balance is not excessive, but enough to pay for the working capital needs and a periodic reduction of government and bank loans which the firm borrowed when it was privatised. The firm’s owners borrowed cash from the bank and the government when the firm was bought from the government. The general manager said that: “The total buying price is Nakfa 12, 000,000. Out of this total cost 3,000,000 is owed to the government, to be paid in seven years, while the 9,000,000 is borrowed from the bank at interest of 9% per year to be paid in ten years”.

Asmara Milk Factory does not consider short-term loans from banks, long-term debt, retained earnings, bank overdraft, trade creditors, secured borrowings or accruals as sources of financing its working capital investments. The response of the financial manager to interview questions indicated that, Asmara Milk Factory uses cash collected from operations to finance its working capital investments operations. According to the
financial manager, sales growth, price levels of inputs, operating efficiency, seasonality of sales, the firm’s credit policy and availability of credit do not influence the levels of short-term financing (See Appendix 8.2.2).

Managing working capital finances - comparison of privatised firms

Sources, costs and influences of working capital financing All three privatised firms (Asmara Milk Factory, Asmara Sweater Factory and Eritrean Steel Sheet Factory) use cash collected from operations to finance their short-term financing needs. However, Asmara Sweater Factory and Eritrean Steel Sheet Factory also use short-term debt and bank overdraft. Only Asmara Milk Factory reported that its operations result at cash surplus so it does not have any external cost of financing its working capital investments. However, the other two firms - Asmara Sweater Factory and Eritrean Steel Sheet Factory use bank overdraft loan with annual interest costs of around 9.5% to finance their short-term investments in working capital assets.

According to the financial managers of Asmara Sweater Factory and Eritrean Steel Sheet Factory, the main factors that influence the levels of financing of working capital levels are price levels of inputs and operating efficiency. The financial manager of Asmara Sweater Factory also considers sales growth as a factor influencing the levels of short-term financing. On the other hand, the financial managers of the three-privatised firms believe that seasonality of sales, credit policy and availability of credit do not determine the levels short-term financing for working capital investments (see Appendix 8.2.2).

8.3.3. Managing working capital operations

8.3.3.1. Purchase management

In this section we study if Asmara Milk Factory creates value by managing working capital operations of purchases. We asked the general manager who is also the commercial manager on the firm’s purchase policy, purchasing techniques, purchasing activities and costs as well as on approaches of contacting, contracting and control of suppliers. For detailed information on managing working capital operations with regard to purchases, refer to Appendix 8.2.3.1.

Purchase policies The firm’s suppliers are also its owners, so they have vested interests in the firm. When the factory was slated for privatisation its suppliers organised themselves and bought the factory. So, almost all suppliers are co-operative owners of the factory. However, according the general manager, any person who can supply milk above 10 litres per day can come to the place of the factory and register as supplier. The factory buys whatever its supplier-owners sell. The manager said that: “At the moment the factory is owned by its suppliers so it is difficult for us to refuse milk presented to the factory by a supplier-owner. It is their firm, and we cannot refuse them even if the demand for milk is so low that it may result at loss such as during fasting months”. As a solution for this problem the factory produces more butter and less pasteurised milk when the demand is low, though the profit margin of butter is much lower compared to that of milk.
Asmara Milk Factory purchases its materials on a credit basis with a policy geared towards smoothing out production during normal periods of supply, to take care of seasonal fluctuations in demand and production requirements and to take advantage of quantity discounts. According to the commercial manager, the firm’s purchase policy is also to decrease inventory holding and ordering costs. The firm forecasts its materials purchase requirements in order to establish the quantity on hand and on order during lead time, to determine the safety stock requirement and to meet its production demands. The base that the firm uses to estimate materials purchase requirement is mainly its past experience. Asmara Milk Factory has a long-standing agreement with two factories (Asmara Brewery and Keih Bahri Food Products) whose by-products serve as animal feed. It has an agreement with these factories that they sell their animal feed only to those who supply milk to Asmara Milk Factory. So, when suppliers are registered with Asmara Milk Factory they will have the right to buy animal feed from the factories. This procedure serves as a control mechanism for suppliers not to shift to other competitors. The agreement between the factory and the animal feed supplying factories was established when all three firms in the linkage (Asmara Milk Factory, Asmara Brewery and Keih Bahri Food Products) were government owned.

Contacting, contracting and controlling suppliers Asmara Milk Factory makes efforts to find suppliers by getting in contact and describing the materials to potential suppliers. According to the commercial manager, the costs of the efforts made to find suppliers are significant and therefore relevant for the management. When entering into contract with a potential supplier the firm evaluates the proposal and negotiates the agreement and the manager believes that the costs are relevant to attract managerial attention. Overall, according to the commercial manager, the costs of contacting, contracting and controlling suppliers are relevant to the management. Therefore, management uses approaches like choosing the cheapest channel of communication, making its terms of agreement known to its suppliers in advance, developing long-lasting relationships, managing by trust and routine contract agreements but it does not employ lawyers or purchase agents.

8.3.3.2. Sales management

In this section we study if Asmara Milk Factory creates value by managing working capital operations of sales. With this objective in mind we asked questions on sales policy, selling and distribution techniques, sales activities and costs, approaches of contacting, contracting and control of customers. For detailed information on managing working capital operations of selling see Appendix 8.2.3.2.

Sales policy According to the firm’s general manager, Asmara Milk Factory sells its products only to local markets and its sales policy is a door to door approach. According to the general/commercial manager, Asmara Milk Factory’s approach to find markets for its products is by getting directly in contact with potential customers. The firm sends market investigators to ask shops, restaurants and bars if they are willing to buy milk from the factory, which it will bring to their place of business, free of charge. So if they are willing they become regular customers. The firm does not make any other effort like, attending trade fairs and exhibitions, advertising products in the public media, distributing free samples for promotion or describing the goods to potential buyers. The firm sells on cash basis to small customers and on credit basis (using the
5 Cs) to the larger customers and government firms. According to the general/commercial manager, the reason why it makes preferential customer treatment is because of the trust factor. He says: “The larger private firms and all government firms are highly trusted and will not fail to pay back their debt, while the small private firms buy smaller amounts whose collection cost and effort does not warrant credit selling and may not pay back on time”. Its sales objective is to take care of regular customer demands. In our interview with the general-commercial manager we have come to understand that the firm’s other sales objective is to decrease inventory holding costs. It forecasts its sales requirements in order to determine safety stock requirements but not to manage inventory usage or to determine the quantity on hand and on order during lead-time. The firm uses statistically forecasted sales as a base to plan the sales volume but not the opinion of the sales staff.

Contacting, contracting and controlling customers Asmara Milk Factory contacts its customers by directly approaching potential customers. It also negotiates the sales agreement with potential customers, including the terms of sale and evaluates the proposed purchase terms of its customer. However, the firm does not sign the agreements. Asmara Milk Factory also relies on the commitment and trust of its customers. However, according to the general/commercial manager’s experience the probability that customers will back down from their agreement is none and if partners back down the loss is small and it is not difficult to find another customer. Moreover, he believes that the overall costs of contacting, contracting and controlling customers is not relevant to the management. Therefore, it uses approaches such as making terms of agreement known in advance, developing long-lasting relationships and routine contract agreements but it does not employ lawyers or sales agents.

8.3.3.3. Managing working capital operations - comparison of privatised firms

Management of purchase operation The managers of Asmara Sweater Factory and Asmara Milk Factory reported that they purchase materials mainly to get cash discounts, while Eritrea Steel Sheets Factory aims at getting quantity discounts and minimising the costs of inventory holding. They all forecast the purchase of materials based on past experience; however, Asmara Sweater and Eritrea Steel Sheets Factories also use forecasted sales volume and management opinion. Asmara Sweater Factory and Asmara Milk Factory purchase both on cash and credit terms while Eritrean Steel Sheet Factories purchase only on cash basis because its commercial manager says that the firm’s suppliers do not provide credit.

Asmara Milk Factory controls its suppliers by agreeing with animal feed producing factories such that they sell only to those certified by Asmara Milk Factory. The costs of the efforts made to contact, contract and control suppliers are relevant only to Asmara Milk Factory. Moreover, the commercial managers of all firms replied that they use approaches such as choosing the cheapest channel of communication and making terms of agreement known in advance to contact suppliers as well as having routine contract agreement with terms known in advance during contracting. They install routine control procedures with terms known in advance to both partners as control measures. However, none of them employs lawyers or purchase agents to manage the costs of contact, contract and control of suppliers (see also Appendix 8.2.3.1).
Management of sales operation All privatised firms sell their products to the local market while Asmara Sweater Factory also exports. The commercial managers of all privatised firms said that the objective of their sales policy is to satisfy customer demands. The objective of sales policy for Asmara Sweater factory and Eritrean Steel Sheet Factory is also to decrease the costs of inventory ordering and holding as well as to expand their market share. Asmara Sweater Factory has also the objective of meeting seasonal sales requirements. All three privatised firms forecast sales based on past experience and also use statistical forecasts while Asmara Sweater and Eritrean Steel Sheet Factories also use management opinion. Only Eritrea Steel Sheets Factory uses the opinion of its sales staff to forecast its sales. Asmara Sweater and Eritrea Steel Sheet Factories forecast sales in order to estimate future demand as well as to establish inventory usage and the quantity on hand and on order during lead-times. Asmara Milk Factory and Eritrea Steel Sheet Factory forecast sales to determine safety stock requirements.

The privatised firms produce for the general market while Asmara Sweater Factory and Eritrean Steel Sheet Factory also produce by the order of specific customers. Asmara Sweater and Eritrea Steel Sheet Factories ensure that their customers do not back down from their agreement by having a written contract. The firms reported from their experience that there is no probability of customers backing down from their agreement and the difficulty of getting another customer is small. Eritrea Steel Sheet Factory and Asmara Milk Factory choose the cheapest channel of communication to contact customers and they enter into routine contract agreements with terms known in advance of transaction to get into contract and control customers. All firms do not employ sales agents or lawyers to facilitate the contacting, contracting and controlling customers.

Concluding remark As a result of the data collected through interviews and questionnaires we can conclude that the privatised firms use relatively better approaches to manage the levels of their working capital investment compared to the government and the transition firms. All the firms apply a credit policy both with their suppliers and customers. However, their credit sales policy depends on the trust they have in the customer. The trust depends on whether their partner is government or privately owned. Government firms are trusted and are offered credit. While their policy towards private firms depends on the experience and the size (using the 5C’s as a measuring criteria) of the firm. The more positive the experience and the larger the size of the firms the more the possibility that the credit applicant will get credit. The privatised firms are also observed to control the holding costs of working capital investment levels more efficiently. They make explicit agreements with their suppliers and customers to minimise repetitive contacts and contracts, which increases trust in each other and eliminates strict controls. These measures, we believe create value to the firms because they decrease the costs of inter-firm transactions and increase revenues. This is substantiated by the fact that all the privatised firms except Asmara Sweater Factory have net profits, net cash inflows and good performance indicators (See Appendix 8.2.3.4).

8.3.4. Performance evaluation of working capital decisions

Up to this section, we dealt with the internal working capital management approaches applied by the privatised firms. Here, we explore if they evaluate the performance of
their working capital related management decisions, and if they do what type of performance measurement criteria they apply. We particularly asked the managers what type of performance measurement criteria they use to measure their performance and how they evaluate the result of their decisions. For supporting data to this section refer to Appendix 8.2.3.3.

We also evaluated the result of their decisions as it is reflected in the firms’ seven year (1994 - 2000) financial statements. We applied various types of financial performance indicators using the approach of ratio analyses. For detailed information on financial analyses of working capital decisions, refer to Appendix 8.2.3.4 (Asmara Milk Factory) and 8.2.3.5 (comparative financial analyses of the privatised firms).

**Performance measurement and evaluation criteria** According to the firm’s financial manager, Asmara Milk Factory evaluates the performance of its working capital decisions by comparing the performance of its past with the present and the actual with the expected. However, it does not compare its performance with other firms using inter-firm benchmarks. Moreover, as it is indicated in Appendix 8.2.3.3, the financial manager did not indicate any specific accounting based criteria he uses to measure the firm’s performance. However, the firm uses customer satisfaction criteria particularly on quality of products by decreasing defect rates as well as communication-based criteria following the policy of fast delivery time.

Moreover, by taking data from the firm’s financial statements, we computed accounting based performance measurement and evaluation criteria to study the firm’s financial position. We divided the evaluation of Asmara Milk Factory’s financial performance into three sections. First, we studied the investment composition using asset structure ratios. Second, the liquidity and short-term financing composition ratios are used to evaluate efficiency of the firm’s working capital financing and liquidity position. Third, we used activity and profitability ratios to study the firms overall efficiency in turning over the working capital assets and generating profit. Appendix 8.2.3.4 contains the financial analysis of working capital decisions referring to Asmara Milk Factory’s investment, financing and operational performance.

### 8.3.4.1. Performance evaluation of working capital investment

**Working capital investment composition** We analysed the financial statement data to find the composition of Asmara Milk Factory’s investments. We used asset structure ratios particularly working capital to total assets and its breakdowns - inventory, receivables and cash to working capital. Financial statements for 1994 and 1995 are not included, because until the end of 1995, its financial statements were consolidated with other three firms. We used the terms “inventories” and “stock” as well as “accounts receivable” and “debtors” inter-changeably. We have used the terms inventories and receivables in our literature review while empirically we found that the firms in Eritrea use the terms “stock” for “inventories” and “debtors” for “accounts receivable”.

*Working capital to total assets ratio:* As Appendix 8.2.3.4 reveals, asset structure ratios of Asmara Milk Factory for the seven years studied reveal that current assets to total assets is an average of 52%. As it is indicated by Figure 8-1 the firm’s asset
structure decreased sharply when it went private and then increased sharply in the year after privatisation. As it is revealed by Figure 8-1, the short-term debt compared to the total assets accounted to a relatively smaller percentage both before and after privatisation implying that short-term debt was not used to finance the total assets to a large extent.

**Figure 8-1: Asset structure and short-term debt leverage – Asmara Milk Factory (1996-2000)**

In order to study the composition of each working capital element in the total working capital investment, we computed inventory to working capital, receivables to working capital and cash to working capital. The computations revealed a seven-year average of inventory to working capital of 40%, receivables to working capital of 11% and cash to working capital of 49%. For the trend over the seven years, see Figure 8-2.

**Figure 8-2: Working capital investment composition (%) – Asmara Milk Factory (1996-2000)**

**Source: Appendix 8.2.3.4**

**Concluding remark** Generally the investment in working capital is not large when compared with the global norm. From the detailed computations (Appendix 8.2.3.4) it can be observed that Asmara Milk Factory’s major working capital investment is in inventories and idle cash. The investment in receivables is minimal, indicating the firm’s lack of credit policy. Its inventory investment has shown a sharp increase in 1998, which then remained constant. Overall the inventory levels has remained at an acceptable range
because the firm does not keep inventory for a long time due to the perishability of the inventory, low production capacity and high demand for its products. The trend in the investment in cash balances is observed to be the opposite of inventory. It revealed a very sharp decrease in 1998 when the inventory balance increased, indicating that the increase in the level of inventory caused the cash levels to diminish. The working capital to total assets ratio has gradually decreased over the last two years.

8.3.4.2. Performance evaluation of working capital financing

We analysed Asmara Milk Factory’s financial statements using liquidity and short-term financing composition ratios in order to evaluate its liquidity position and to study how the firm’s investments are financed.

**Liquidity position** The liquidity position of Asmara Milk Factory is analysed using current and quick ratios, which respectively show a seven-year average of 1.5 and 1.1 times the current liabilities. This also supports the firm’s deteriorating asset structure after its privatisation (see Figure 8-3).

**Figure 8-3: Liquidity position – Asmara Milk Factory (1996-2000)**

![Liquidity Position Chart](chart.png)

*Source: Appendix 8.2.3.4*

**Short-term financing composition** As it is indicated in appendix 8.2.3.4 short-term financing of Asmara Milk Factory is composed mainly of non-trade creditors (such as provision for taxation and dividend payable) and trade creditors which on the average accounted for 44% and 37% of the total respectively. The remaining 19% is short-term bank loans. The factory does not use bank overdraft to finance its working capital investments (see also figure 8.4.).
After privatisation trade creditors which increased to an average of 44% surpassed the other financing sources, followed by short-term bank loans amounting to 42% while other financing sources are on the average of 14%.

8.3.4.3. Performance evaluation of working capital operations

We used activity and profitability ratios to study the efficiency and profitability of Asmara Milk Factory’s working capital operations. More data on the performance evaluation of working capital operations is indicated in Appendix 8.2.3.4.

Operational efficiency of working capital activities The firm’s financial statement data are analysed using activity ratios to study the efficiency of the firm’s operations of purchasing, cash payments, selling and cash collections. Activity ratios show the efficiency of managing working capital items or how fast receivables, payables and inventories are converted or turned over. The ratios include, inventory turnover, accounts receivable turnover and overall working capital turnover. In order to simplify the analysis we also computed the days that inventories and receivables are held.

Inventory turnover of Asmara Milk Factory indicates average annual cost of goods sold is 4.8 times average inventory, which means that inventory was held 76 days during the year on average. Receivables turnover shows that, annual sales is 38.4 times average receivables, that is receivables were turned over every 10 days. Overall working capital turnover shows that sales is 3.1 times the average current assets. As it can be observed from Figure 8-5 the firm’s inventory turnover has been constantly low throughout the seven years while its receivables turnover shows a higher turnover except for the two years (1998 and 1999) until its privatisation, which then picked up indicating a change of credit collection policy.
The receivables turnover ratio shows a relatively short period taken to collect receivables possibly due to efficient receivables collection management. However, the inventory turnover ratio indicates a relatively slow moving inventory. This implies that the days inventory is held is relatively long while the average receivables collection period is short. Again, overall working capital turnover is rather low and does not give a promising indication as to the efficient utilisation of working capital investment.

**Concluding remark** The receivables turnover ratio shows a relatively short period taken to collect receivables possibly due to efficient receivables collection management. However, the inventory turnover ratio indicates a relatively slow moving inventory. This implies that the days inventory is held is relatively long while the average receivables collection period is short. Again, overall working capital turnover is rather low and does not give a promising indication as to the efficient utilisation of working capital investment.

**Overall profitability** We computed profitability ratios (gross profit margin, net profit margin and return on assets) to study the efficiency of the firm’s operations in generating profit during the seven years. Profitability ratios relate the firm’s profit to sales, costs and assets invested. The firm’s gross profit and net profit margins are an average of 17% and 9% of the annual sales respectively. The return on assets shows that the net profit after tax is on the average 20% of total assets. However, a reference to figure 8-6 indicates that the gross profit and net profit margins of Asmara Milk Factory are continuously deteriorating since 1998.

**Source:** Appendix 8.2.3.4
Cash flow Analysis Table 8-1 reveals that the net cash flows of Asmara Milk Factory was positive during the first two years but finally decreased. It can also be observed that inventories decreased and creditors increased so both items contributed positively to the net cash inflows while receivables had negative impact. However, the percentage effect of the individual items indicate that inventories contributed 27% of the increase in net cash flows while receivables and creditors made a negative contribution of 30% and 14% respectively. The fact that the overall net cash flow ended up at a positive average implies other items were the major sources of cash for the firm.

Table 8-1: Cash flow analysis – Asmara Milk Factory (figures in ‘000)

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Net cash flow</td>
<td>2319</td>
<td>1474</td>
<td>-1128</td>
<td>889</td>
</tr>
<tr>
<td>B. Net cash flow to total assets</td>
<td>22%</td>
<td>13%</td>
<td>-8%</td>
<td>9%</td>
</tr>
<tr>
<td>D. Annual change</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase (-), decrease: stocks*</td>
<td>671</td>
<td>410</td>
<td>-287</td>
<td>265</td>
</tr>
<tr>
<td>Increase (-), decrease: debtors*</td>
<td>-21</td>
<td>-666</td>
<td>499</td>
<td>-63</td>
</tr>
<tr>
<td>Increase, decrease (-): creditors**</td>
<td>67</td>
<td>83</td>
<td>556</td>
<td>235</td>
</tr>
<tr>
<td>E. Annual % effect on NCF</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase (-), decrease: stocks</td>
<td>29%</td>
<td>28%</td>
<td>25%</td>
<td>27%</td>
</tr>
<tr>
<td>Increase (-), decrease: debtors</td>
<td>-1%</td>
<td>-45%</td>
<td>-44%</td>
<td>-30%</td>
</tr>
<tr>
<td>Increase, decrease (-): creditors</td>
<td>3%</td>
<td>6%</td>
<td>-49%</td>
<td>-14%</td>
</tr>
<tr>
<td>Others: Increase, decrease (-)</td>
<td>-69%</td>
<td>11%</td>
<td>68%</td>
<td>17%</td>
</tr>
</tbody>
</table>

*(Year1-year2), **(Year2-year1)
Source: computed from the firm’s financial statements

Concluding remarks The profitability measures show that the firm has a sound profit position. The firm has monopolised the supply of materials through its connection with the firms producing animal feed. This has enabled the firm to purchase raw materials at favourable terms and lowers its cost of production. Moreover the firm’s sizeable profit margin could also be attributed to its monopoly in a market with increasing demand, which the firm may get difficulty to sustain if more competitive private firms would come in the future. However, the decreasing trend of its gross and net profit margins as well as return on assets indicates a demanding problem which need further study and analysis.

Pre and post privatisation financial performance Comparing financial analysis of the pre and post privatisation reveals that the firm’s current asset to total assets ratio has decreased by about 43% mainly because of additional investment in fixed assets. While the working capital investments in inventories have increased by 62%, the working capital investment composition in cash has decreased by 38%. Moreover, the working capital investment composition in receivables has only marginally decreased by about 17%. Its liquidity position in terms of both current and quick ratios has also deteriorated. Moreover, after privatisation the firm shifted from financing its working capital investment using accrual accounts such as taxes and dividends payable (which showed a decrease of 73%) to short-term bank loans and trade creditors, which respectively increased by 223% and 26%. The firm’s inventories, receivables and overall working capital turnovers all indicate an increase after privatisation. However, the firm’s profitability measures particularly gross profit and net profit margins have decreased by 17% and 70% respectively after privatisation. Figure 8-6 reveals that
privatisation did not help the firm to improve its profitability. For more information on pre and post privatisation financial performance refer to Appendix 8.2.3.4.

**General evaluation of post privatisation development** According to the general manager, both the personnel composition and policy of the management has not been changed from what it used to be before privatisation. However, Asmara Milk Factory has invested in production machines and transportation vehicles with the help of a soft loan obtained from DANIDA (a Danish co-operation firm). As a result of this investment it has added new product lines, particularly for the production of Cheese and Yoghurt. These two products according to the firm’s general manager will help to smooth the seasonal fluctuations in the demand of the firm’s products. According to the general manager, the firm increased its production capacity after privatisation. It has increased both the volume and types of products. The factory is processing 18,000 litres per day compared to 4000 litres before privatisation - an increase of 300%. However, the number of employees after privatisation [which stands at about 50 employees in the year 2000] has decreased.

### 8.3.4.4. Performance management - comparison of privatised firms

In this section we make a comparative analysis of the impact of management’s decisions on the privatised firms’ investments, financing and operations. For more information refer to Appendix 8.2.3.3 for comparative performance measurement and evaluation criteria and Appendix 8.2.3.5 for comparative accounting based performance evaluation.

**Performance measurement and evaluation criteria** According to their financial managers, all three privatised firms evaluate performance of their working capital investment decision using comparative analysis of past versus present and actual versus expected (except for Eritrea Steel Sheets Factory) but none of them use inter-industry benchmarks. They apply communication based particularly having the policy of fast delivery time to satisfy their customers. Asmara Sweater Factory and Eritrea Steel Sheets Factory also take care of their customers by minimising costs and charging lower prices and having fast response to their demands. Eritrea Steel Sheets Factory and Asmara Milk Factory also increase the quality of their products by decreasing defect rates. Asmara Sweater Factory and Eritrea Steel Sheets Factory apply some accounting based performance measurement and evaluation criteria. Both firms evaluate their liquidity using current and quick ratios, their working capital activity using inventory and receivables turnover ratios, their profitability using gross profit, return on working capital and return on total assets. While Asmara Sweater Factory also evaluates its working capital activity using overall working capital turnover, its working capital investment composition using inventory, receivables and working capital to total assets, Eritrea Steel Sheets Factory also evaluates its working capital investment composition using cash to working capital ratio. The computation of the firms’ accounting based performance indicates the following results.

**Investment** We evaluated the efficiency of managing overall investment by analysing asset structure ratios. The average current assets to total assets for Asmara Sweater Factory, Asmara Milk Factory and Eritrean Steel Sheet Factory are 66%, 52% and 85% respectively. The average working capital investment composition of inventory, receivables and cash to total working capital respectively shows 83%, 17% and 2% for
Asmara Sweater Factory, 40%, 11% and 49% for Asmara Milk Factory and 39%, 33% and 24% for Eritrean Steel Sheet Factory. Eritrea Steel Sheets Factory with 85% recorded the highest current assets to total assets ratio while Asmara Milk Factory had only 52% of its assets invested in the current.

**Financing** We used liquidity ratios (current and quick ratios) and composition of short-term financing to study the liquidity position and short-term financing management of the privatised firms. The current and quick ratio positions respectively are an average of 0.7 and 0.2 for Asmara Sweater Factory, 1.5 and 1.1 for Asmara Milk Factory and 2.2 and 1.3 for Eritrean Steel Sheet Factory. Sembel Steel Sheets Factory is the only liquid privatised firms. Though Asmara Milk Factory slightly above the global norm quick ratio its current ratio fell below the globally acceptable norm of 2. Asmara Sweater Factory reported below the norm in both the current and quick ratios and it can therefore be conclude that it has a real problem of liquidity.

The composition of trade creditors, short-term bank loans, bank overdraft and others accruals are respectively 13%, 2%, 77%, 8% for Asmara Sweater Factory. Short-term financing composition for Asmara Milk Factory as indicated earlier was composed of 37% trade creditors, 19% short-term bank loans, 0% bank overdraft and 44% accruals. Moreover, that of Eritrean Steel Sheet Factory was 33%, 14%, 22% and 32% respectively for trade creditors, short-term bank loans, bank overdraft and other accruals. The privatised firm use different sources of short-term financing. While Asmara Milk Factory used both trade creditors and other sources such as dividend payable and provision for taxation, Asmara Sweater Factory used mostly Bank overdrafts. Eritrea Steel Sheets Factory used trade creditors (including credits to related enterprises up the period of its privatisation) and other sources such as short-term loans and bank overdraft after it was privatised, dividend payable and provision for taxation before it was privatised.

**Operations** We also studied the privatised firms’ efficiency in managing overall operations by analysing activity and profitability ratios. The activity ratios, for the three firms - Asmara Sweater Factory, Asmara Milk Factory and Eritrean Steel Sheet Factory show an average inventory turnover of 0.7 (or 358 days), 4.8 (or 76 days) and 1.4 (or 260 days), respectively. Accounts receivable turnover reveals 8.6 (or 42 days), 38.4 (or 10 days), and 2.4 (or 152 days) respectively. Working capital turnover was 0.7, 3.1 and 0.9 respectively. Except for the abnormally high receivable turnover recorded by Asmara Milk Factory, the inventories, receivables and overall working capital turnovers for all the privatised firms is low. Moreover, relatively, Asmara Milk Factory registered the highest turnover in all the working capital activity ratios.

Profitability ratios for Asmara Sweater Factory, Asmara Milk Factory and Eritrean Steel Sheet Factory show an average gross profit margin of 22%, 17% and 19% respectively while net profit (loss) margin was (35%), 9% and 6% respectively while the return on assets was (19%), 13%, and 10% respectively. Asmara Sweater Factory is the only privatised firm which has recorded loss both pre and post privatisation. The other two privatised firms were profitable throughout the years that we have studied (except that Eritrea Steel Sheets factory made loss during the first year after its privatisation).

**Cash flow Analysis** Comparison of the net cash flows of the privatised firms revealed that all the privatised firms have increasing trend o net cash flows with Asmara
Sweater Factory having the largest average increase and Eritrea Steel Sheet Factory
the lowest average increase. However, inventory and creditors increased on the
average for the firms during the years except for Asmara Milk Factory, which had a
no change f creditors balance. Inventory made the largest impact on net cash flows for
Asmara Sweater Factory and Eritrea Steel Sheet Factory while debtors made the
largest impact for Asmara Milk Factory cash flows.

Concluding remarks Asset compositions of the privatised firms show that a large
proportion (an overall average of 68%) of the total investment is in current assets. This
(according to their managers) is because the firms have serious problems of production
capacity due to lack of a finances to pay for the investment in capital assets. The liquidity
ratios indicate that the firms have differing degrees of liquidity. Asmara Sweater Factory
has a problem of liquidity and Asmara Milk Factory is marginally liquid while Eritrean
Steel Sheet Factory has slightly more than the normally acceptable liquidity. Operational
performance indicators for Asmara Sweater Factory, Asmara Milk Factory and Eritrean
Steel Sheet factory indicate very low inventory turnovers, resulting in a long periods that
the assets are held and the overall working capital turnover for all the firms is low. These
low turnovers have resulted at a problem of generating profit for Asmara Sweater
Factory. However, Asmara Milk Factory and Eritrean Steel Sheet Factory generated
profit. Comparatively Asmara Milk Factory has the highest inventory and receivables
turnovers, shortest period receivables and inventory are held and this has intern resulted
at the highest net profit margin and return on assets, which is a sign of relative success.

Post privatisation financial performance Comparing financial performance of the
pre and post privatisation periods reveals that the privatised firms’ current asset to
total assets ratio has decreased except for Eritrea Steel Sheets Factory because of
additional fixed assets investment. However, their liquidity position in terms of both
current and quick ratios has remained almost unchanged on average. We also checked
the short-term debt to total assets ratio to study the extent of short-term debt used in
financing the firms assets. This ratio indicates that the privatised firms have decreased
their short-term debt ratio after they were privatised. The composition of inventories
and cash in the total working capital have also decreased by 23% and 58%
respectively while the average investment in debtors has increased by more than 4.5
times. The firms’ inventories, receivables and overall working capital turnovers also
indicate a marginal increase after privatisation. While the average gross profit ratio
has increased by 57%, their average net profit margins and return on assets have
decreased by 6 and 1.3 times respectively mainly because of the extremely poor
performance of Asmara Sweater Factory after privatisation. Moreover, it can also be
observed that Asmara Milk Factory and Eritrea Steel Sheets Factories net profit
margins and returns on assets have relatively decreased after privatisation though both
remained positive.

Post privatisation working capital management One year after our data collection,
we contacted the general managers of the privatised firms to find out whether they
have made changes on management, investments and operations after they are
privatised. We tried to find information on the developments that the firms have made
with regard to management in terms of both composition of the personnel and general
managerial policy. We also investigated if the privatised firms have made any
investment expansion or retraction of product lines or products. Our findings indicate
that generally, the privatised firms made changes in terms of both management
personnel and policy. We found out that all have introduced some policy changes with regard to operations and linkages. Two privatised firms have made some capital investments, closed some production lines and have started to concentrate mainly on those products that the management considered profitable.

8.4. External working capital management – supplier and customer linkages

This section explores if the privatised firms have proper inter-firm co-operation on the primary activities on both the supplier side and the customer side. With this objective in mind we asked the firms’ general, financial and commercial managers if and how they co-operate with their supplier and customer linkages on the primary activities as well as on purchase and inventory management. We then asked what benefits they get as a result of their co-operation or why they do not co-operate. First, we review the response of one of the privatised firms – Asmara Milk Factory and compare the responses of the privatised firms. Then we examine the responses of the suppliers and customers. For detailed information on external working capital management and inter-firm co-operation, see Appendix 8.3.1 – for the responses of firms on firm-supplier co-operation (8.3.1.1) and firm-customer co-operation (8.3.1.2), Appendix 8.3.2 – for response of suppliers and Appendix 8.3.3 – for responses of customers.

8.4.1. Firm-supplier co-operation

8.4.1.1. Responses of the central firms – Asmara Milk Factory

The objective of studying firm-supplier co-operation in this section is to know if Asmara Milk Factory creates value by co-operating with its suppliers so that it decreases costs of inter-firm transaction relation by managing supplier linkages. We asked the firm’s managers if and how they co-operate on primary activities including purchase and materials inventory management and what benefits they get as a result of their co-operation or why they do not co-operate.

Firm-supplier co-operation on primary activities According to the general manager, who also acts as commercial manager, the primary activities that Asmara Milk Factory strongly co-ordinates with its supplier include, inbound activities, production operation and marketing and sales. However, it has weak suppliers’ co-operation with its suppliers on activities related to after sale services.

Firm-supplier co-operation on purchase and inventory management Asmara Milk Factory co-ordinates its materials purchase and inventory management with suppliers by specifically agreeing on the quality and quantity of materials to be purchased, the terms of transportation as well as supplying the materials purchased just in time for production.

However, the firm’s co-operation policy is only with selective suppliers because the commercial manager believes it is not beneficial to co-operate with all suppliers. In addition to this some suppliers also lack the willingness to co-operate. Moreover, the financial manager does not believe that this co-operation reduces the cost of inventory
ordering and carrying, the time and cost of purchasing materials and it does not help in creating firm-supplier trust.

Moreover, according to the general manager, this results in a mutual benefit and two-way co-operation between Asmara Milk Factory and its suppliers. On one side, the suppliers are also owners, so as owners they help in supplying the firm with materials, on the other hand, the firm provides its suppliers with the exclusive right to get animal feed from the animal feed producing factories. Therefore, the firm’s sustainability of supply is ensured as a result of its agreement with the firm’s suppliers of suppliers - Asmara Brewery and Keih Bahri Food Product. As per the agreement, the factories sell animal feed only to the suppliers of the factory whose list Asmara Milk Factory sends periodically. In the interview conducted with the Asmara Milk Factory’s general manager he said that: “Our suppliers prefer to buy the animal feed from the two factories for two reasons. First the animal feed is in short supply so the only way that they can ensure the availability of their supply is to continue their relation with the two animal feed producing factories. Second, Asmara Brewery and Keih Bahri Food Products are government firms so their price is cheaper”.

Post privatisation - supplier and customer co-operation According to the general manager Asmara Milk Factory has added new supply lines outside Asmara. It is now collecting milk using its collection offices from towns 40 to 50 kilometres outside Asmara such as Mendefera and Dekemhare. Moreover, the factory is still maintaining the linkages that it had established with both its suppliers and suppliers of suppliers. Asmara Milk Factory has also opened new markets in Masawa about 115 kilometres outside Asmara. The general manager is hopeful that the new products (Cheese and Yoghurt) will enable the firm to satisfy its customers and to enable it to have closer customer relationships.

Concluding remarks Asmara Milk Factory is co-operating with its suppliers because the firm’s suppliers are its co-operative owners too, so they have vested interest in supplying milk to the firm. In addition to this, we also found the linkages between Asmara Milk Factory and the animal feed producing factories serving as major control mechanism for suppliers to continue dealing with the firm and settle their debts on time. Both reasons have helped the firm and its suppliers to remain closely linked and minimise the cost of the firm’s contact, contract and control and be more profitable.

8.4.1.2. Firm-supplier co-operation - comparison of privatised firms

Firm-supplier co-operation on primary activities Asmara Milk and Asmara Sweater Factories replied positively to firm-supplier co-operation on primary activities (see Appendix 8.3). They reported that they co-operate with their suppliers on inbound activities and production operations. As it is mentioned earlier in this section Asmara Milk Factory also co-operates with its suppliers on marketing and sales activities except on advertisement. However, Eritrean Steel Sheet Factory does not co-operate with its suppliers in any of the primary activities because, as the firm’s general manager responses to the interview questions revealed, its suppliers are abroad and the firms-supplier linkages are dictated by the import-export regulations of the government.
**Firm-supplier co-operation on purchase and inventory management** Asmara Milk Factory and Asmara Sweater Factory co-ordinate their materials purchase and inventory management with suppliers by specifically agreeing on the quality and quantity of materials to be purchased as well as supplying the materials purchased just in time for production. Moreover, the commercial manager of both Asmara Sweater Factory and Asmara Milk also believe that the firms co-operate with their suppliers on the terms of transportation. However, as a result of its co-operation only Asmara Sweater Factory replied that it gets benefits such as a decrease in the time needed to purchase the materials and costs of ordering and purchase as well as in creating inter-firm trust.

Where the firms are not co-operating with their suppliers they replied that it is because the firms themselves do not have the specific policy and their suppliers have not developed the business culture of co-operation. The commercial managers of Asmara Sweater Factory and Eritrean Steel Sheet Factory reported that they have selective policy because they do not see the benefit of co-operating with all their suppliers.

**Concluding remark** We conclude from the findings of the privatised firms’ management of working capital operations and levels that it takes time for privatised firms to fully develop the efficiency and supplier linkages exemplified by private firms. Asmara Milk Factory is still influenced by its historical legacy as government firm, particularly with regard to its supplier linkages because the government has allowed the firm to continue dominating the supply market since suppliers are indirectly obliged to sell to the firm, else no animal feed. However, we find Asmara Sweater Factory breaking its past experience as a government firm. It has shifted its source of supply from Keih Bahri Tannery (a government firm in transition to privatisation) to Tesfagiorghis Beatay Leather Factory (a private firm) because according to the general manager of Asmara Sweater the private firm has more flexible and efficient production and better customer relations.

**8.4.1.3. Responses of supplier – DAS-UoA**

In order to answer section 2(c) of the second research question: “*How do privatised firms in Eritrea manage their firm-supplier linkages*”, we had to find the response of their suppliers. We evaluated the firm-supplier co-operation on primary activities and on sales and inventory management as well as related benefits or the reasons for non-co-operation. We also study the supplier evaluation of firm efficiency. So, we approached the farm manager of a farm owned by the University of Asmara – Department of Animal Science (DAS), one of the main suppliers of Asmara Milk Factory whose responses follow.

**Firm-supplier co-operation on primary activities** The farm manager believes that the two firms do not co-operate on the primary activities like production operations, outbound activities, marketing/sales and after sales service. However, they have an agreement that the DAS sells its daily milk production to Asmara Milk Factory and that it maintains an agreed quality and fat content. In return Asmara Milk Factory provides DAS with animal feed through its connection with Keih Bahri Food
Products. Moreover, the farm manager is not satisfied with the purchasing system of Asmara Milk Factory. He says that: “The factory’s buying price is low, it is closed during holidays, it decreases its purchases during religious fasting periods and does not give transportation services unlike its main competitor Asmara Meat and Milk Factory”. His opinion is that Asmara Milk Factory forces its suppliers to stick to it by having an agreement with animal feed producing factories such as Keih Bahri Food Products, which the manager believes is very unfair business dealing. He believes that it is unfair because the suppliers cannot shift to alternative suppliers on the basis of other criteria than getting the supply of animal feed, such as higher prices or customer efficiency in inter-firm transaction relations.

Firm-supplier co-operation on sales and inventory management: The supplier of Asmara Milk Factory does not believe that it efficiently co-operates its sales and inventory management with its customer. The only co-operation reported is on credit transactions without discount and in providing goods when just needed but not on exchanging skilled staff. The farm manager is therefore not satisfied with the purchase, shipment and transportation system of Asmara Milk Factory. As a result of its dissatisfaction, he said that: “We are in the process of changing our customer from Asmara Milk Factory to its main competitor Asmara Meat and Milk Factory, which is a recently privatised firm”. The manager believes that this lack of co-ordination is mainly because Asmara Milk Factory has not developed the business culture of co-ordinating its inventory and purchase activities. However, he is of the opinion that, it is not because the farm does not have the specific policy on customer co-operation or that it does not see the benefit of closely co-operating with a specific customer. Moreover, the limited co-operation helps in decreasing the time need to sell and the costs of selling goods, but it does not help to minimise the costs of transportation.

Supplier assessment of firm efficiency The manager's opinion is that Asmara Milk Factory is efficient in its payment habits and in taking advantage of the services that DAS offers. However, it is less efficient in its marketing approach and purchase order processing. The farm and Asmara Milk Factory exchange special services most frequently on product quality and less frequently on employee training. Generally, the farm manager believes that the co-operation between the two firms is not good mainly because Asmara Milk Factory is inefficient in providing transportation, storage and customer treatment. The manager said that if it is to be competitive, the factory has to provide these services and establish milk collection centres located in the vicinity of its suppliers.

Concluding remarks Unlike what the general manager of Asmara Milk Factory claims, (that it fully co-operates with its suppliers on purchasing and materials inventory management), the opinion of its supplier tells us a different story. The firm’s purchasing and inventory management is geared totally in favour of the factory. According to its supplier the firm’s linkages with the suppliers’ of suppliers help the firm to practice unfair business dealings because regardless of its efficiency, suppliers are forced to continue their linkages.
8.4.1.4. Firm-supplier co-operation - comparison of suppliers of privatised firms

In order to get a comparative response of firm-supplier linkages, we approached the suppliers of the two privatised firms. These suppliers include, Tesfagorgis Beatay Leather Factory - supplier of Asmara Sweater Factory and University of Asmara – Department of Animal Science (UOA-DAS) - supplier of Asmara Milk Factory. The responses of the two suppliers follow and for more information refer to Appendix 8.3.1.2.

**Firm-supplier co-ordination on primary activities** Only the supplier of Asmara Sweater Factory replied that the two firms co-operate on outbound activities particularly, order processing and delivery vehicle operations as well as on marketing and sale/purchase, specifically advertisement. Otherwise, both suppliers replied that they do not co-operate on other primary activities such as outbound activities, production operations or after sale service.

**Firm-supplier co-operation on sales and inventory management**: The suppliers of privatised firms do not believe that they co-operate their sales and inventory management with their customers. The only co-operation reported is on credit transactions without discount and providing with goods when just needed by the customer but not on exchanging skilled staff. The suppliers believe that this lack of co-ordination is mainly because the privatised firms do not co-operate. However, their opinion that, it is not because they do not have the specific policy on customer co-operation or that they do not see the benefit. Moreover, the limited co-operation helps them to decrease the time needed to sell and the cost of selling goods and carrying inventory as well as it assists in creating inter-firm trust.

**Supplier assessment of firm efficiency** Both suppliers of Asmara Milk Factory and Asmara Sweater Factory agree that the firms are efficient on their payment habits. However, it is only the supplier of Asmara Sweater Factory who believes that the firm is efficient in processing purchase orders, bilateral communication, explanation to inquiries, courtesy and marketing approach.

**Concluding remarks** As a result of the interviews conducted and questionnaire responses received from the suppliers of the two privatised firms, we conclude that the firms have differing policy on firm-supplier co-operation. Asmara Milk Factory keeps its firm-supplier linkages using adversarial tactics, a typical character of a government or monopoly firm. While Asmara Sweater factory co-operates with its supplier on an equal footing using collaborative tactics. Therefore, the supplier of Asmara Sweater Factory is much more satisfied and willing to co-operate in the future compared to the supplier of Asmara Milk Factory. We find a clear indication that the firm-supplier linkage of Asmara Milk Factory is temporary because if Asmara Milk Factory’s co-operation with the suppliers of suppliers is lifted, its suppliers will shift to other competitors unless the firms shifts to more co-operative approaches.

8.4.2. Firm-customer linkages

In order to study how efficient privatised firms manage their customer linkages we asked their general and commercial managers about what and how they co-operate on primary
activities, sales operations and inventory management. We also inquired on the benefits the privatised firms get as result of their co-operation or why they do not co-operate and whether the firms assess their customers’ opinion.

8.4.2.1. Responses of the central firms – Asmara Milk Factory

This section deals with the firm-customer co-operation from the point of view of Asmara Milk Factory. For more information refer to Appendix 8.3.1.2.

Firm-customer co-operation on primary activities According to the general manager, the primary activities that Asmara Milk Factory strongly co-ordinates with its customers include, production operations (packaging, assembly, equipment maintenance, product testing and facility operations), outbound activities (delivery vehicle operations, materials handling and order processing as well as finished goods warehousing). Its customer co-operation also includes on marketing and sales particularly with respect to the promotion and sales channel selection but not with respect to advertising. The factory has weak inter-firm co-operation with its customers in all activities related to after sale service.

Firm-customer co-operation on sales and inventory management According to the commercial manager of Asmara Milk Factory, the firm co-ordinates its sales and inventory management with customers by specifically agreeing on the transportation terms, quality and quantity of goods to be produced and sold on the basis of just in time. According to the financial manager the benefit that the firm gets is increasing sales but the co-operation does not help in minimising the cost of transportation or the cost of carrying inventories.

Customer assessment The firm gets the feedback of customers opinion on the quality of its products and services by allowing them to return any product with inferior quality and making strict quality control at the production floor. But it does not make periodic assessments on customer opinion.

Concluding remarks As much as it dominates the supply market Asmara Milk Factory more or less dominates the demand market. There are few and smaller milk processing factories in the country, which can effectively compete with the factory in supplying milk and milk products. However, we find that the small milk processing factories and the black market of direct sales of milk to consumers by the milk producers has exerted enough pressure on the factory. This has motivated the factory to co-operate with its customers on primary activities, particularly transporting to their place of business and allowing credit to its larger customers.

8.4.2.2. Firm-customer co-operation – comparison of privatised firms

Firm-customer co-operation on primary activities The managers of Asmara Milk and Asmara Sweater Factories responded that they strongly co-operate with customers on production operations (particularly - packaging, assembly, equipment maintenance, product testing and facility operations) as well as on outbound activities (such as materials handling, order processing and finished goods warehousing). Asmara Milk Factory also co-operates with its customers on outbound activities with respect to the
delivery vehicle operations while Asmara Sweater Factory co-operates on the after sales services particularly with respect to installation and after sales services. Eritrean Steel Sheet Factory does not have specific co-operation with its customers in any of the primary activities. The privatised factories have weak co-operation with customers in all activities related to marketing and after sale service.

Firm-customer co-operation on sales and inventory management According to the commercial managers of Asmara Milk Factory and Asmara Sweater Factory, they co-operate with their customers on sales and inventory management. They specifically have mutual agreements on the transportation terms, quality and quantity of goods to be produced and sold on the basis of just in time. According to their financial managers the benefit that the firms get is increasing sales but the co-operation does not help to minimising the cost of transportation or the cost of carrying inventories. The commercial manager of Eritrea Steel Sheets Factory however, believes that the firm does not get any benefit because it has no specific co-operation with its customers. The commercial manager of Eritrean Steel Sheets Factory replied that the weak firm-customer co-operation is because the firm does not have the policy and because it does not see any benefit in co-operating with a specific customer. In addition to this customers have not developed the business culture of co-ordinating their management with suppliers.

Customer assessment All three privatised firms get the feedback of their customers’ opinion on the quality of products and services by allowing their customers to return any product with inferior quality and making strict quality control at the production floor. Asmara Sweater Factory and Eritrean Steel Sheet Factory reported that they also make periodic assessments of their customer opinion. However, none of the privatised firms allow its customers to pay only if the products are as per their expectation.

Concluding remarks Comparatively, Asmara Milk and Asmara Sweater Factories have small but numerous competitors, so both have demonstrated remarkable signs of competition to satisfy the demand of their customers by developing firm-customer linkages. The managers of both firms believe that they co-operate with their customers on the primary operations particularly, outbound activities and in some areas of production operation like packaging. However, Eritrean Steel Sheet Factory is the only one in the country producing steel sheets. This has enabled it to completely dominate the market as a result of which it does not bother to create any firm-customer co-operation.

8.4.2.3. Responses of customer – Berhane Frafre

In order to find out and analyse the views of the customers of the privatised firms, interviews were made and structured questionnaires distributed to their customers. In this section we study the firm-customer co-operation of Asmara Milk Factory from the point of view of one of its main customers – Berhane Frafre. We search for specific co-operation on the customer’s primary activities, purchase operations and inventory management. We will also review the customers’ opinion on the benefit that they get as a result of their co-operation with the privatised firms or the reasons why
they do not co-operate. Finally, we study the customer evaluation of firm efficiency. For detailed supporting information, see Appendix 8.3.3.

**Firm-customer co-operation on primary activities** According to the owner-manager of Berhane Frafre, Asmara Milk Factory co-operates only on inbound activities particularly order processing, materials handling and delivery vehicle operation or transportation. The two firms do not co-operate in all the other primary activities, such as production operations, marketing/sales and after sale service.

**Firm-customer co-operation on purchase and inventory management** According to the owner-manager of Berhane Frafre, the only purchase related co-operation is on credit transaction without discount. The two firms do not co-operate on other activities such as exchanging skilled staff, credit transaction with discounts or providing goods when just needed. Hence the owner-manager of Berhane Frafre believes that there are no benefits such as the decrease in the time and cost of purchasing or decrease in the holding costs of inventory. She also believes that this lack of inter-firm co-operation does not enhance the creation on inter-firm trust. According to the manager of Berhane Frafre the weak inter-firm co-operation is because Asmara Milk Factory has not developed the business culture of co-ordinating its management policy with its customers. However, it is not because Berhane Frafre does not have the specific policy or that it does not see the benefit of closely working with a specific supplier. The owner-manager of Berhane Frafre says that: “Asmara Milk Factory was government owned until recently and it is the only major milk-processing firm. So most of the firms dealing with milk products are forced to be its customers”.

**Customer assessment of firm-efficiency** The manager of Berhane Frafre rates Asmara Milk Factory as very efficient in its cash collection habits, in sales processing, impartiality with other buyers, explanation to inquiries and delivery. She has also rated the factory as efficient in product quality and bilateral communication. However, the manager believes and that the factory is less efficient in minimising the costs of its products, in using customer services and in its marketing approach.

**Concluding remarks:** From the point of view of the owner-manager of Berhane Frafre, the inter-firm co-operation of Asmara Milk Factory on most of the primary activities, purchase operations and inventory management is weak. The owner-manager blames Asmara Milk Factory for not having the proper policy of inter-firm co-operation and traces the cause to the fact that Asmara Milk Factory is dominating the market and not doing much in trying to satisfy its customers.

8.4.2.4. Firm-customer co-operation - comparison of customers of privatised firms

**Firm-customer co-operation on primary activities** According to the opinion of their customers the privatised firms co-operate on the inbound activities particularly on order processing. It is only Asmara Milk Factory, which according to the opinion of its customer, that co-operates on production operation, particularly materials handling and delivery vehicle operation. There is no co-operation on primary activities such inbound activities (other than those mentioned above), production operations, marketing and sales or after sales services.
**Firm-customer co-operation on purchase and inventory management** According to the opinion of the customers, the only activity related to purchases that both privatised firms co-operate with their customers is in granting credit without discount. Moreover, the customer of Eritrea Steel Sheet Factory also reported that the two firms co-operate in providing goods when just needed. The customers also believe the cause for the weak inter-firm co-operation is that the privatised firms have no policy of co-operating their management policies with that of their customers.

**Customer evaluation of firm efficiency** The two customers believe that the firms are efficient in their cash collection, delivery, product quality, impartiality with other buyers and bilateral communication. The customer of Asmara Milk Factory also believes that the firm is efficient in sales processing and explanations to enquiries, while the customer of Eritrean Steel Sheet Factory believes that its supplier is efficient in its familiarity with customers’ needs. However, both agree that the firms are less efficient in their marketing approaches and in using customer services.

**Concluding remark** Overall, the customers reported that the firm-customer co-ordination of the privatised firms is limited only to the inbound activities, which includes order processing, materials handling and transportation for Asmara Milk Factory and only order processing for Eritrean Steel Sheet Factory. Moreover, the customers revealed that they are not satisfied with the way the privatised firms are handling their firm-customer relations. We find the main reason for this is that Asmara Milk Factory and Eritrean Steel Factory have been transferred from a government monopoly to a private monopoly, which has motivated the firms not to have sufficient interest in their firm-customer linkages.

### 8.5. Conclusions

In this chapter we presented the empirical data analysis of Asmara Milk Factory’s internal working capital management, its supplier linkage with DAS and its customer linkage with Berhane Frafre. A comparative data analysis of working capital management is also made among the three privatised firms – Asmara Milk Factory, Asmara Sweater factory and Eritrean Steel Sheet Factory.

**The role of working capital management** The managers of Asmara Milk Factory and Eritrean Steel Sheet Factory believe that managing working capital levels and operations can have a major role in the creation of firm value. As a result they reported that it takes a lions share of their time for which they are fully empowered. The privatised firms have more or less identified their policy on how to manage their working capital levels and operations, which they all claim is tailored towards generating profit by increasing sales and decreasing costs. However, we still observe problems in the speed by which the privatised firms adapt to the culture of private business management.

**Working capital investment and financing** The objective of cash management of all the privatised firms is to take care of routine transactions, because after what has been spent to buy the firms from the government during privatisation, there is very little money left. The firms have been bought from the government in the last couple
of years of our study mostly by borrowing heavily from the government banks. Therefore, except for Eritrean Steel Sheets Factory they are getting problems of liquidity for working capital purposes and their investment capacity has been affected. As a result, they reported that they lack production capacity and therefore they have very little finished goods inventory in order to bother about its costs. Only Asmara Milk Factory provides credit to its larger customers. The other two firms have very little investment in receivables and do not bother about managing it. In the absence of financing capacity for both working capital and fixed capital investment, managers are concentrating on controlling the costs and physical safety of their existing investments and financing sources.

Working capital operations The management of the firms working capital operations was restricted to the application of clerical procedures of purchasing and selling. Analysis of purchase and sales operations however showed that there is no mechanism of enhancing the contact, contract and control aspects of purchase and sales operations.

Evaluation of internal working capital management Our study of performance evaluation has indicated that most privatised firms evaluate their performance by comparing their past with the present and actual with the expected. However, they neither compare their performance with their competitors nor do they use inter-firm benchmarks to compare their performance with other firms in their industry. They apply communication based particularly having the policy of fast delivery time to satisfy their customers. Asmara Sweater Factory and Eritrea Steel Sheets Factory also take care of their customers charging lower prices and having fast response to their demands. Eritrea Steel Sheets Factory and Asmara Milk Factory have a policy to improve the quality of their products. Asmara Sweater Factory and Eritrea Steel Sheets Factory evaluate their liquidity, working capital activity and investment composition as well as their profitability. On the other hand ASARA Milk Factory uses neither customer satisfaction nor accounting based performance criteria to assess its performance.

Financial analysis showed that the firms have differing liquidity position. Asmara Sweater Factory has liquidity problems, Asmara Milk Factory is marginally liquid while Eritrea Steel Sheets Factory has no problem of liquidity. Investment in current assets, (whose overall working capital turnover ratios are low for all the firms), is modest for Asmara Sweater Factory and Asmara Milk Factory, but excessive for Eritrea Steel Sheets Factory. All profitability ratios (gross profit, net profit and return on assets) for Asmara Milk Factory and Eritrea Steel Sheets Factory is positive while that of Asmara Sweater Factory shows negative levels except for gross profit margin.

Inter-firm co-operation The privatised firms’ external working capital management on supplier linkages showed that Asmara Milk Factory controls its supply market and keeps its suppliers by controlling their supply line. Eritrean Steel Sheet Factory imports its materials totally from abroad so it has very little contact with its suppliers. Asmara Sweater Factory has a very competitive supply market and is establishing closer firm-supplier linkages. The privatised firms’ customer linkages show that Asmara Milk Factory and Eritrea Steel Sheet Factory still dominated their local market while Asmara Sweater Factory is exporting its products through its connection with another factory in Italy, which belongs to the same owners.
We also obtained the responses of suppliers and customers to study how they perceive the privatised firms’ external management of working capital operations and levels. One of the suppliers responded that it is forced to sell to the privatised firm in fear of loosing the sources of his firm’s supply, which is controlled by the privatised firm because of the agreement between the privatised firm and the firm that produces his supply. According to the supplier this is a very improper business dealing and this power base is encouraging the privatised firm to ignore the interests of its suppliers. The supplier of the second privatised firm reported that she is happy with regard to the inter-firm co-operation on transportation of the products but that she had reservations on other issues such as co-operation on credit facilities and inventory storage. We also approached two customers and both responded that their inter-firm co-operation with the privatised firms on their primary operations is weak. The customers believe that the cause for not co-operating is because the privatised firms have not developed the business culture of co-ordinating their management policies with their customers.

Moreover, the empirical findings show that the privatised firms have not completely freed themselves from the business practice they were used to when they were government firms. The internal management of their working capital levels and operations as well as external management of supplier and customer linkages closely resemble that of transition and government firms. There are two main reason for this conclusion. First, there are no relevant private firms that can compete with the privatised firms so that the privatised firms can learn from. In addition to this, the government policy on market liberalisation and the war with Ethiopia has not encouraged for new entrants in the market. Hence the privatised firms are more or less as dominant as when they were government firms. Second, it is observed that the firms have changed ownership, where the owners took over the top management who administer mostly in abstention and still maintained most of the top management. For example, final management decisions in Asmara Milk Factory is done at the annual general meetings of the co-operative owners, the general manager of Asmara Sweater factory resides in Italy and the general manager of Eritrea Steel Sheets Factory we were told is abroad and the manager represents him mostly. We believe this has caused less exposure to new management policies and reluctance to changes.

The privatised firms’ supplier and customer co-operation is very unsatisfactory from their supplier and customer points of view. Both linkages reported that there are few activities that the firms co-ordinate in their supplier-customer linkages. Overall findings reveal that the privatised firms are improving their working capital management. Therefore, we believe that for a successful transformation from government to private ownership, a well established private sector is needed to serve as point of reference to the privatised firms and to put pressure on them so that they try to enhance competition and improve inter-firm linkages. Changing ownership alone will not help firms to increase their value creation potential. Employing management with academic and practical experience, the use of proper technology and enhancing market competition determine the firms’ efficiency and value creation.

Post privatisation developments One year after we collected the original data, we went back to the privatised firms to study if they have made any policy changes with regard to personnel management, production capacity expansion and product diversification. We found encouraging developments because generally, a change in terms of both management personnel and policy is observed in all the privatised firms.
We observed that the management team in two of the three firms is lead by the owners as general managers and the former general managers hold the position of managers under the owners. The former general manager in the third firm still holds the position of general manager. However, all have introduced some policy changes with regard to internal operations and external linkages. We also investigated if the privatised firms had made any investment expansion or retraction. We particularly investigated if the firms have invested in new machines, overhauled old machines and trained employees. We found out that two of the three privatised firms have made some capital investments. They have also closed some production lines and have concentrated only on those products that the management considered profitable. With regard to linkages, the privatised firms have made changes in both their supplier-customer linkages and in their policies towards the linkages.