

7th International Economics & Business Management Conference, 5th & 6th October 2015

Working Capital Management Efficiency: A Study on the Small Medium Enterprise in Malaysia

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Abstract

This preliminary study was made with an attempt to analyze the efficiency of working capital management in the selected small medium enterprise companies in Malaysia. The secondary data was derived from Suruhanjaya Syarikat Malaysia. Database of 24 companies are randomly selected from the SME Corp website for four years period from 2010 - 2013. In analyzing the efficiency of working capital management three indexes was used in this current study namely, performance index of working capital management (PI_{WCM}), utilization index of working capital management (UI_{WCM}), and efficiency index of working capital management (EI_{WCM}). The results reveal that the selected small medium enterprise company was less efficient in managing their working capital during this study period.

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Peer-reviewed under responsibility of Universiti Tenaga Nasional

Keywords: Working capital management; Efficiency index; SME; Malaysia

1. Introduction

Essentially, working capital management (WCM) is one of the most vital segments in firm's financing decisions as an important stimulus towards firm's performance. The importance of WCM towards firm's achievement was considered as a traditional concept that was highlights in all standard corporate finance textbooks (Aktas, & Croci, & Petmezas, 2015). Above all, efficient management of working capital is a fundamental part of the overall corporate strategy (Padachi, 2006) and is expected to contribute positively to the creation of a firm's

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value (Nazir & Afza, 2009). Thus, the importance of managing the working capital (WC) efficiently is irrefutable in certifying each components of working capital are at the best level of efficiency to successfully operate and is highly desirable for firm's growth and sustainability because of its effects on profitability and risk (Tsagem, Aripin & Ishak, 2014).

The corporate finance literature has traditionally focused on the study of long-term financial decisions, particularly investments, capital structure, dividends and company valuation decisions. Recently, short-term assets and liabilities, which are considered as important components of total assets, are now gaining more interest across the different industry by converging towards WCM efficiency. Accordingly, efficient WCM also revolve on monitoring of current assets and existing liabilities in a way to minimize the potential debt and also to keep the firms from too much spending on the asset (Eljelly, 2004). In addition, efficient WCM will allows firms to redeploy underutilized of firm's resources to higher-valued use in which could heightening of firm's performance (Aktas, & Croci, & Petmezas, 2015).

Many study done previously focus on larger firms or important industry and literature on WCM in Malaysian context are relatively rare particularly on small firms (Nasruddin, 2006) whereas small firms also need to have proper management on working capital (Sajid et.al, 2013). The need to effectively manage the WC within SMEs remain pivotal to its solvency and liquidity (Sunday, 2011). Thus, measuring of the efficiency of SME' working capital is prominent by looking at the growth of SME in Malaysia that was expending rapidly with 97.3% (645,136) of total business establishments (Economic Census, 2011). Further, SME industry complement 33.15% of GDP, 57.5% employment and 19% exports contribution towards Malaysia's economic (SME Corporation, 2012). Of important, the health of the SME sector is highly imperative to the economy thus it's vital to look into the efficiency of working capital management of small medium enterprise in Malaysia context. Working capital management is important to ensure the sustainability of the companies in order to keep growing to compete with others. Thus, the purpose of this paper is to analyse the efficiency of working capital management in the selected small medium enterprise companies as a beginning for future analysis. Since, many facets of WCM efficiency is still unexplored particularly from Malaysian's SME, research in this local aspects is meaningful.

2. Literature Review

Previously, WCM has been analysed from different measure in current literature. Study done by Mehmet and Eda, (2009) on the significant relationship between working capital management of the firm efficiency level evidenced the efficient used of WC by improving the management of total assets in which positively affect the firm profitability. This study used declared data from Istanbul Stock exchange from 1993 to 2007 and indicates significance negative relationship of cash conversion period, current ratio and net working capital towards return on total assets. Similar to Chisti, (2012) studied the effect of efficiency and profitability for the 16 company in India and found that the are inverse relationship between the inventory, account receivable and cash conversion cycle, but in contrast the accounts payables show the positive relationship. Whereas, Ganesan (2007) analyze the efficiency of the working capital management for the telecommunication equipment industry and used day's sales outstanding, days inventory outstanding, day payable outstanding, day's working capital, and current ratio to represent the working capital management efficiency. Meanwhile, cash conversion efficiency and current ratio are used to measure the liquidity and income to total assets and income to sales used to measure the profitability. Results of the empirical analysis show that liquidity and profitability are negative relationship towards the working capital management.

Study done by Alipour, (2011) on the relationship between working capital management and profitability found that there is significant relationship and from the empirical results show that the working capital management play a big roles in the profitability in Tehran stock exchange and the study suggest that to decrease the receivables accounts and inventory in order to increases the shareholders values. On other research complete by Jayarathne (2014) on the impact of the working capital management on profitability and used Sri Lanka listed company as sample. He summarized on his results that the liberal credit policy would be influencing to the profitability of the company and suggests that manufacturing companies can make more profit if they can manage the working capital management efficiently. Similarly to the study done by, Richard et.al (2013) to examine the effects on working capital management on profitability in manufacturing firms in Ghana and found that components in working capital management must be managed properly to avoid problem on liquidity crisis and the short-term liabilities since it's also play a big role in companies. For this research, he used account receivable days, account payable days, cash

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