UNIVERSITI TEKNOLOGI MARA

THE EFFECT OF WORKING CAPITAL MANAGEMENT ON FIRM PROFITABILITY: EVIDENCE FROM MANUFACTURING FIRMS LISTED ON BURSA MALAYSIA

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ABSTRACT

The main purpose of this study was to examine the effect of working capital management on the firm profitability of manufacturing firms listed on Bursa Malaysia. The specific objective of this study was to determine the effects of the independent variables which are Average Collection Period (ACP), Inventory Conversion Period (ICP) and Average Payment Period (APP) on firm performance of listed manufacturing firms on Bursa Malaysia. Firm performance was measured using dependent variable which is Return on Assets (ROA). This study used descriptive research design to describe the effects of working capital management on firm profitability. The target population was the 10 selected manufacturing firms which are listed at Nairobi Securities Exchange. A census of the 9 firms listed manufacturing on Bursa Malaysia from year 2006 to 2015 was the sample. This research project utilized secondary data, which was collected by use of content analysis obtained from the Datastream. The collected data was entered into the Eviews8 and Pooled OLS regression analysis method was used to analyze the data. In the regression model, it revealed a significant effect and negative relationships among Average Collection Period (ACP), Inventory Conversion Period (ICP) and Average Payment Period (APP). This study also recommends that manufacturing firms should ensure that they have a framework on managing the working capital since it has direct impact on their profitability.

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CHAPTER ONE
INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Working capital management is one of the important things for the firm because it affects the profitability, risk and also the value of the firm (Smith, 1980). The results are likely to improve the profitability tends to increase the risk, and vice versa, the results of which focuses on risk reduction would tend to reduce potential profits. According to Eljelly (2004), efficient working capital management involves planning and controlling the current assets and current liabilities in a way that eliminates the risk of inability to meet short-term obligations and to avoid excessive investment in the assets. Thus, working capital management (WCM) is the management of short-term financing needs of the firm. This includes maintaining an optimum balance of components of working capital which is receivables, inventories and payables.

Value of a company cannot be maximized in the long run unless it can survive in the short term. Many of the firms often failed because they are unable to meet their working capital requirement. It shows that working capital management is a necessity for firm survival (Deloof, 2003).

Working capital is one of the important components in the financial management. This is because the working capital management requires decisions about the combination of current assets and financing of these assets. Business property is one of the examples of current assets that used to conduct the business and generate revenue in a short period, usually within a year or less than a year. Current assets are readily convertible to cash when it is needed. Furthermore, the success of a company is depending on the ability of a firm to generate cash more than the expenditure. According to Shin and Soenen (1998), on their previous research, it has been prove that there is a strong relationship between the efficiency of working capital management and firm's profitability.