

# **WORKING CAPITAL POLICIES AND FIRM PERFORMANCE**

**BY**

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## **ABSTRACT**

This study is conducted to examine the relationship between the working capital components (ACP, APP, ICP and CCC) and the working capital policies (AIP, CIP, AFP and CFP) with the firms' performance (ROA, ROE and Tobin's Q). This study takes place from 2008 until 2012 and was examined on six sectors listed in Bursa Malaysia which are the construction, consumer products, industrial products, plantations, properties and also trading and services. Ordinary least squares regression and fixed effect model have been used to estimate the relationship between variables. The results showed that different sector may give different results in determining the relationship between the working capital and the firms' performance. Working capital components and firms' performance is negatively related and it can be found in plantations, properties and trading and also services sectors. However, all the sectors showed that working capital policies will impact the firms' performance except the plantations sector.

**Keywords:** Sector, working capital components, working capital policies and firm performance

## **ABSTRAK**

Kajian ini dijalankan untuk mengkaji hubungan di antara komponen modal kerja (ACP, APP, ICP dan CCC) dan polisi modal kerja (AIP, CIP, AFP dan CFP) dengan prestasi syarikat (ROA, ROE dan Tobin Q). Kajian ini dijalankan dari tahun 2008 hingga 2012 dan meliputi enam sektor yang disenaraikan di dalam Bursa Malaysia iaitu pembinaan, barangan pengguna, barangan industri, perladangan, hartanah dan perdagangan dan perkhidmatan. OLS dan FEM digunakan untuk menentukan hubungan di antara pembolehubah. Hasil kajian menunjukkan bahawa sektor yang berbeza memberikan keputusan yang berbeza dalam menentukan hubungan antara modal kerja dan prestasi syarikat. Hubungan di antara komponen modal kerja dan prestasi syarikat di sektor perladangan, hartanah dan perdagangan dan perkhidmatan adalah negatif. Sementara itu, kesemua sektor kecuali sektor perladangan menunjukkan bahawa polisi modal kerja akan memberi kesan kepada prestasi syarikat.

**Katakunci: Sektor, komponen modal kerja, polisi modal kerja dan prestasi syarikat.**

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## **LIST OF ABBREVIATIONS**

ACP	Average collection period
AFP	Aggressive Financing Policy
AIP	Aggressive Investment Policy
APP	Average payable period
BSE	Bombay Stock Exchange
CATAR	Current asset to total assets ratio
CCC	Cash Conversion Cycle
CFP	Conservative Financing Policy
CIP	Conservative Investment Policy
CLTAR	Current liabilities to total assets ratio
CR	Current Ratio
D(AFP)	Dummy for aggressive financing policy
D(AIP)	Dummy for aggressive investment policy
D(CFP)	Dummy for conservative financing policy
D(CIP)	Dummy for investment policy
Dcrisis	Dummy for crisis
EBITDA	Earnings before interest, taxes, depreciation and amortization
FEM	Fixed effect model
GDP	Gross Domestic Products
GOP	Gross operating profit
ICP	Inventory conversion period
KSE	Karachi Stock Exchange
MFP	Moderate Financing Policy
MIP	Moderate Investment Policy
NPV	Net Present Value
OLS	Ordinary least square
ROA	Return on Assets
ROCE	Return on Capital Employed
ROE	Return on Equity
ROIC	Return on Invested Capital

SPSS	Statistical Package for the Social Science
TQ	Tobin's Q
U.S.	United States
VIF	Variance Inflation Factors

## **CHAPTER 1**

### **INTRODUCTION**

#### **1.1 Background of the study**

Working capital management is believed to be a crucial component of any firm's decision making as it influences the firms' entire performance especially during uncertain economic situations. In India, Ernst and Young (2014) noticed that the companies have performed badly in their working capital management compared to their global counterparts. In fact, the survey was conducted among the top 500 Indian companies and the results showed that cash cycle of Indian companies were much longer with 67 days compared to other countries (U.S. 42 days, Europe 41 days, Japan 57 days and 39 days in Asian countries). Besides, Ernst and Young (2014) also stressed that different results in the cash cycle may be due to the macroeconomic factors which are the volatility of exchange rates and the commodity prices. The weaken rupees against other major currencies in 2013 had weaken the firms' performance as it affected EBITDA/sales ratio with the declining rate of 0.8% compared to 2012. This report is contentious regarding how well the firms in other countries adopting working capital management efficiently. It is because of firms in developed and developing countries might be adopting different strategy especially in encountering problems in the economic cycle.

Previously, the two crises which happened in 1997 and 2008 had impacted most of Asian firms. The economic shock in 1997 which was due to the depreciating Thai baht currency had entirely affected the firms. In

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