

**THE EFFECT OF WORKING CAPITAL MANAGEMENT ON FIRMS'  
PROFITABILITY IN MALAYSIA**

**NADZRAH BINTI ABDULLAH**

**MASTER OF SCIENCE (FINANCE)**

**UNIVERSITI UTARA MALAYSIA**

**2014**

**THE EFFECT OF WORKING CAPITAL MANAGEMENT ON FIRMS'  
PROFITABILITY IN MALAYSIA**

**By**

**Nadzrah Binti Abdullah**

**812376**

**Dissertation Submitted to the Fulfillment of the Requirements for the degree of**

**Master of Science (Finance) at the Graduate School Business**

**Universiti Utara Malaysia**

**2014**

## **DECLARATION**

I hereby declare that I am responsible for the accuracy and originality of my work except for quotations and citations that have been duly acknowledged. I also declare this paper has not been previously submitted for any Master's program at Universiti Utara Malaysia or other institutions.

Nadzrah Binti Abdullah

812376

Othman Yoep Abdullah Graduate School of Business

Universiti Utara Malaysia

2014

## **PERMISSION TO USE**

In presenting this thesis in partial fulfillment for a post graduate degree from the Universiti Utara Malaysia, I agree that the university's library may take it freely available for inspection. I further agree that permission for copying of this thesis in any manner, in whole or part, for scholarly purposes, may be granted by my supervisor or, in other absence by the Dean, Postgraduate Studies, and College of Business. It is understood that any copying or publication or use of this dissertation or parts thereof for financial gain shall not be allowed without my written permission. It is also understood that due to recognition shall be given to me and to Universiti Utara Malaysia for any scholarly use which may be made of any material from my dissertation.

Request for permission to copy or to make other use of materials in this dissertation in whole or in parts should be addressed to :

Dean of Research and Postgraduate Studies

College of Business

Universiti Utara Malaysia

06010, Sintok, Kedah, Malaysia

## **ABSTRACT**

This study investigates the relationship between working capital management and firms' profitability in Malaysia. It examines the components in working capital such as days' accounts payable, days' accounts receivables, days' inventory held and cash conversion cycle in relation to return on asset (ROA). In general, this study contributes to the scarce of literature in this area in Malaysia by providing empirical evidences. Data were obtained from DataStream for two sectors in Malaysia. The sectors chosen are construction & material, and food producer sector. The time period for this study covers from year 2008 to 2012. Finding show working capital management affects firms' profitability. In construction and material sector, ROA has negative relationship with days' accounts receivable and days' inventory held, but positive relationship with days' accounts payable. In food producer sector, ROA has negative relationship with days' accounts receivable and payable but negative relationship with days' inventory held. In both sectors, cash conversion cycles are negatively associated with firm profitability. It indicates that longer duration of cash conversion cycle will decreases firm's profitability

## **ACKNOWLEDGEMENT**

Alhamdulillah, all praises and gratitude for Allah SWT for allowing me and giving me the strength to complete this dissertation. Without His permission, I would not be able to complete this study.

Million thanks to my supervisor Associate Professor Norafifah Ahmad for her unlimited guidance in helping me to keep on the right track with this dissertation. This research could have not be completed smoothly without her ideas and comments. I would like to express my sincere gratitude for her patience and knowledge as this study has consumed a lot of her valuable time.

My highest appreciation goes to my husband for providing me with his endless support to achieve my master degree upon completing this study. I really appreciate his consideration and patience for allowing me to concentrate on the study.

I would like to express my special thanks to my parents for supporting my decision to continue my study and for always showing concern about the progress of my study. My deepest appreciation also goes to my friends who have share their ideas and thoughts and who have together through thick and thin. They are my source of strength when I am away from my husband and family.

## TABLE OF CONTENTS

DECLARATION	I
PERMISSION TO USE	II
ABSTRACT	III
ACKNOWLEDGEMENT	IV
TABLE OF CONTENTS	V-VIII
LIST OF TABLES AND FIGURE	VIII-IX

### CHAPTER 1 : INTRODUCTION

1.1	Background of study.....	1-7
1.2	Problem Statement.....	7-8
1.3	Research Questions.....	8-9
1.4	Research Objectives.....	9-10
1.5	Significance of The Study.....	10-11
1.6	Scope and Limitations of Study.....	11
1.7	Organization of Thesis.....	11-12
1.8	Summary of chapter.....	13

## CHAPTER 2 : LITERATURE REVIEW

### 2.0

Introduction.....	14
-------------------	----

2.1 Dependent Variables.....	14-16
------------------------------	-------

2.2 Independent Variables.....	16-35
--------------------------------	-------

2.3 Control Variables.....	35-40
----------------------------	-------

2/4 Summary of Chapter.....	40-41
-----------------------------	-------

## CHAPTER 3 : METHODOLOGY

3.0 Introduction.....	42
-----------------------	----

3.1 Research Design.....	42-43
--------------------------	-------

3.2 Research Framework.....	43
-----------------------------	----

3.3 Hypotheses.....	44-47
---------------------	-------

3.4 Data Collection, sampling and procedure.....	48-50
--------------------------------------------------	-------

3.5 Measurement of Variables.....	50-53
-----------------------------------	-------

### 3.6 Data Analysis Techniques

3.6.1 Descriptive Analysis.....	53
---------------------------------	----

3.6.2 Correlation of Variables.....	53
-------------------------------------	----

3.6.3 Regression Analysis.....	54-55
--------------------------------	-------

3.7 Summary of Chapter.....	55
-----------------------------	----



## CHAPTER 4 : RESULT AND ANALYSIS

4.0	Introduction.....	56
4.1	Construction and Material Sector	
4.1.1	Descriptive Statistic.....	56-57
4.1.2	Correlation Analysis .....	58
4.1.3	Multicollinearity and Autocorrelation Test .....	59-60
4.1.4	Linear Regression Analysis .....	60-63
4.2	Food Producer Sector	
4.2.1	Descriptive Statistic.....	64-65
4.2.2	Correlation Analysis .....	65
4.2.3	Multicollinearity and Autocorrelation Test .....	66-67
4.2.4	Linear Regression Analysis .....	67-70
4.3	Discussion of Findings	
4.3.1	Construction and Material Sector.....	71
4.3.2	Food Producer Sector.....	72
4.4	Summary of Chapter.....	72

## CHAPTER 5 : CONCLUSION AND RECOMMENDATION

5.1	Introduction.....	73
5.2	Summary of Study.....	73-75
5.3	Contribution of the Study.....	75-76

5.4	Implications of study.....	76
5.5	Future Research.....	77
5.6	Conclusion.....	77-78
REFERENCES.....		79-82

## LIST OF TABLES AND FIGURE

3.2	Research Framework.....	43
3.4	Sample Selection Procedure.....	50
3.5	Measurement of Variables.....	52
4.1	Construction and Material Sector	
4.1.1	Descriptive Statistics.....	56
4.1.2	Correlation Matrix.....	58
4.1.3	Multicollinearity and Autocorrelation Test.....	59
4.1.4	Linear Regression Analysis.....	60
4.2	Food Producer Sector	
4.2.1	Descriptive Statistic.....	64
4.2.2	Correlation Analysis.....	65

4.2.3	Multicollinearity and Autocorrelation Test .....	66
4.2.4	Linear Regression Analysis .....	67
4.3	Summary of Findings.....	71

## **CHAPTER 1**

### **INTRODUCTION**

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

The theory in corporate finance is discussed in three main areas. The areas are capital budgeting, capital structure and working capital management (WCM). The capital budgeting and capital structure are the areas which are closely related to financing and long-term investment, and returns, while working capital management is related to managing current assets and current liabilities.

One of the most important factors for a firm to consider is the management of working capital. The components inside WCM consists of current assets and current liabilities. The difference in current asset to current liabilities also reflects a firm's liquidity. The components in working capital consist of inventory, accounts receivable, accounts payable, short-term loans, cash conversion cycle and etc. It is important to have a good assessment of a company's liquidity because a decline in liquidity can lead to a greater risk of bankruptcy.

It is important for a firm to manage its working capital because it is one of the most important factor in corporate finance, which is related to short term financing and investment decision of a firm. The function of obtaining efficient working capital management is to maintain current assets and current liabilities in respect to each other. Working capital management functions to make sure a firm has enough cash flow in order to pay back its current liabilities and operating

The contents of  
the thesis is for  
internal user  
only

## REFERENCES

- Appuhami, B. R. (2008). The impact of firms' capital expenditure on working capital management : An empirical study across industries in Thailand. *International Management Review*, 11-24.
- Bagchi, B., & Khamrui, B. (2012). Relationship between working capital management and profitability: A study of selected FMCG Companies in India . *Business and Economics Journal*.
- Balakrishnan, M. (2011). The effect of the adoption of emerging electronic payments options on improving working capital management and profitability of firms in India. *Journal of Payments Strategy & Systems*, 5(2), 188-208.
- Banos-Caballero, S., Garcia-Teruel, P. J., & Matinez-Solano, P. (2012). How does working capital management affect the profitability of Spanish SMEs 517-529.
- Barine, M. N. (2012). Working capital management efficiency and corporate profitability: Evidences from quoted firms in Nigeria. *Journal of Applied Finance & Banking*, 2(2), 215-237.
- Bellouma, M. (2010). Effects of capital investment on working capital management. *The International Journal of Finance*, 22 (3), 6497-6509.
- Bieniasz, A., & Gołas, Z. (2011). The Influence of working capital management on the food industry management on the food industry. *Journal Of Contemporary Economics* , 5(4), 68-81.
- Chakraborty, K. (2008). Working capital and profitability: An empirical analysis of their relationship with reference to selected companies in the Indian pharmaceutical industry. *The Icfaian Journal of Management Research*, Vol. VII, No. 12,.
- Charitou, M. S., Elfani, M., & Lois, P. (2010). The effect of working capital management on firm profitability: Empirical evidence from an emerging market. *Journal of Business and Economic Research*, 8(12), 63-68.
- Charitou, M., Lois, P., & Santoso, H. B. (2012). The relationship between working capital management and firm's profitability: An empirical investigation for an emerging Asian country. *International Business & Economics Research Journal*, 11(8), 839-848.

- Ching, H. Y., Novazzi, A., & Gerab, F. (2011). Relationship between working capital management and profitability in Brazilian listed companies. *Journal Of Global Business and Economics*, 74-86.
- Deloof, M. (2003). Does working capital management affect profitability of Belgian firms? *Journal of Business Finance and Accounting*, 573-587.
- Erasmus, P. (2010). The relationship between working capital management and profitability for South African listed industrial firms. *The Business Review, Cambridge*, 15( 1), 193-198.
- Fred Shelton, J. (2002). Working capital and the construction industry. *Journal of Construction Accounting and Taxation*, 23-27.
- Garcia, J. F. (2011). The Impact of working capital management upon companies' profitability: evidence from European companies.
- Horne Van, J., & Wachowicz Jr., J. (2000). In *Fundamentals of Financial Management (11th edn)*. Prentice Hall.
- Iqbal, A., Mulani, J., & Kabiraj, S. (2013). Leverage, size of the firm and profitability: A case of Pakistani cement industry. *IJBIF*, 7(1), 16-22.
- Jose, M. L., Lancaster, C., & Stevens, J. L. (1996). Corporate returns and cash conversion cycle. *Journal of Economics and Finance*, 33-46.
- Lazaridis, I., & Tryfonidis, D. (2006). Relationship between working capital management and profitability in the Athens stock exchange. *Journal of Financial Management and Analysis*, 26-35.
- Makori, D. M., & Jagongo, A. ( 2013). Working capital management and firm profitability: Empirical evidence from manufacturing and construction firms listed on Nairobi securities exchange, Kenya. *International Journal of Accounting and Taxation*, 1(1)
- Malik, M. S., & Bukhari, M. (2014). The impact of working capital management on corporate performance: A study of firms in cement, chemical and engineering sectors of Pakistan. *Pakistan Journal of Commerce and Social Sciences*, 134- 148.
- Mansoori, E., & Muhammad, J. (2012). The effect of working capital management on firm's profitability: Evidence from Singapore. *Interdisciplinary Journal Of Contemporary Research In Busines* , 4(5), 472-486.

- Mohamad, N. E., & Saad, N. B. (2010). Working capital management: The effect of market valuation and profitability in Malaysia. *International Journal of Business and Management* 5(11).
- Nazir, M. S., & Afza, T. (2009). Impact of aggressive working capital management policy on firms' profitability. *The IUP Journal of Applied Finance*, 15(8), 19-30.
- Nazir, M. S., & Afza, T. (2009). Working capital requirements and the determining factors in Pakistan. *The Icfai Journal of Applied Finance*, 15(4).
- Nobanee, H., Abdullatif, M., & AlHajjar, M. (2011). Cash conversion cycle and firm's performance of Japanese firms. *Asian Review of Accounting*, 19(2), 147-156.
- O.N, A., & Radharamanan, T. (2011). Analysis of effects of working capital management on corporate profitability of Indian manufacturing firms. *IJBIF*, 5(1)
- Palombini, N. V., & Nakamura, W. T. (2012). Key factors in working capital management in the Brazilian market.
- Perković, G. (2012). The impact of working capital management on profitability of manufacturing firms in Bosnia and Herzegovina. *Sarajevo Business and Economics Review*, 117-138.
- Pouraghajan, A., & Emamgholipourarchi, M. (2012). Impact of working capital management on profitability and market evaluation: Evidence from Tehran stock exchange. *International Journal of Business and Social Scienc*, 3(10), 311-318.
- Saghir, A., Hashmi, F. M., & Hussain, M. N. (2011). Working capital management and profitability evidence from Pakistan firms. *Interdisciplinary Journal Of Contemporary Research In Business*, 3(8), 1092-1105.
- Sharma, A., & Kumar, S. (2011). Effect of working capital management on firm profitability: Empirical evidence from India. *Global Business Review*, 159-173.
- Shin, H.-H., & Soenen, L. (1998). Efficiency of working capital management and corporate profitability. *Financial Practice And Education*, 37-45.



- Shubita, M. F. (2013). Working capital management and profitability: A case of industrial Jordanian companies. *International Journal of Business and Social Science*, 4(8), 108-115.
- Singla, H. K. (2011). Does firm size affect profitability? An empirical investigation of Indian textile industry. *Paradigm*.
- Taani, D. K. (2012). Impact of working capital management policy and financial leverage on financial performance: Empirical evidence from Amman stock exchange. *International Journal of Management Sciences and Business Research*, 10-17.
- Tahir, M., & Anuar, M. B. (2011). The effect of working capital management on firm's profitability: A review paper. *Interdisciplinary Journal Of Contemporary Research In Business*, 365-376.
- Thapa, P. D. (2013). How does profitability get affected by working capital management in food and beverage industry? *Journal of Advanced Research in Management*, 79-88.
- Usama, M. (2012). Working capital management and its effect on firm's profitability and liquidity: In other food sector of (KSE) Karachi stock exchange. *Arabian Journal of Business and Management Review (OMAN Chapter)*, 62-73.
- Wasiuzzaman, S., & Arumugam, V. C. (2013). Determinants of working capital investment: A study of Malaysian Public Listed Firms. *AABFJ*, 7(2), 49-69.
- Yazdanfar, D. (2013). Profitability determinants among micro firms: Evidence from Swedish data. *International Journal of Managerial*, 9(2), 150-160.