THE EFFECT OF WORKING CAPITAL MANAGEMENT ON FIRMS’ PROFITABILITY IN MALAYSIA

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THE EFFECT OF WORKING CAPITAL MANAGEMENT ON FIRMS’ PROFITABILITY IN MALAYSIA

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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
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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
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REFERENCES


