THE EFFECTS OF WORKING CAPITAL MANAGEMENT ON SMEs
PROFITABILITY IN MALAYSIA

BY

RAHIMA ABASS ALI

Thesis Submitted to
Othman Yeop Abdullah Graduate School of Business,
Universiti Utara Malaysia,
in partial Fulfilment of the Requirement for the Master of Science (Finance)
Saya, mengaku bertandatangan, memperakukan bahawa
(I, the undersigned, certified that)
RAHIMA ABASS ALI (815149)
Calon untuk Ijazah Sarjana
(Candidate for the degree of)
MASTER OF SCIENCE (FINANCE)
telah mengemukakan kertas projek yang bertajuk
(Has presented his/her project paper of the following title)

THE EFFECTS OF WORKING CAPITAL MANAGEMENT ON SMEs
PROFITABILITY IN MALAYSIA

Seperti yang tercatat di muka surat tajuk dan kulit kertas project
(As it appears on the title page and front cover of the project paper)

Bahawa kertas projek tersebut boleh diterima dari segi bentuk serta kandungan dan
meliputi bidang ilmu dengan memuaskan.
(That the project paper acceptable in the form and content and that a satisfactory
knowledge of the field is covered by the project paper).

Nama Penyelia : DR. AZIRA ABDUL ADZIS
(Name of Supervisor)

Tandatangan : ______________________________
(Signature)

Tarih
(Date) : 20TH JANUARY, 2015
PERMISSION TO USE

In presenting this dissertation/project paper in partial fulfilment of the requirements for a Post Graduate degree from the Universiti Utara Malaysia (UUM), I agree that the Library of this university may make it freely available for inspection. I further agree that permission for copying this dissertation/project paper in any manner, in whole or in part, for scholarly purposes may be granted by my supervisor(s) or in their absence, by the Dean of Othman Yeop Abdullah Graduate School of Business. It is understood that any copying or publication or use of this dissertation/project paper parts of it for financial gain shall not be allowed without my written permission. It is also understood that due recognition shall be given to me and to the Universiti Utara Malaysia (UUM) in any scholarly use which may be made of any material in my dissertation/project paper.

Request for permission to copy or to make other use of materials in this dissertation/project paper in whole or in part should be addressed to:

Dean of Othman Yeop Abdullah Graduate School of Business
Universiti Utara Malaysia
06010 UUM Sintok
Kedah Darul Aman
ABSTRACT

This study investigates the effect of working capital management on SMEs profitability in Malaysia using a sample of 66 SME manufacturing firms covering from 2006 until 2012. *Ordinary least square (OLS)* regression is used to estimate the relationship between the independent and dependent variables. The results show that, there is negative relationship between working capital management measures i.e. days account receivables (DAR), inventory turnover in days (ITID), and cash conversion cycle (CCC) and SMEs profitability proxies i.e. return on assets (ROA) and return on equity (ROE) except for net operating profit (NOP) which is having positive effect with CCC. Furthermore, the study shows that there is positive relationship between days account payables (DAP) and SMEs profitability measured by (ROA and ROE) but having a negative relation with NOP. The results imply that Profitability of SME manufacturing firms depends upon effective working capital management. Therefore, this study suggests that SME manufacturing companies can improve their profitability by managing working capital properly.

KEY WORDS: Working capital, working capital management, manufacturing Sector, Malaysia, SMEs, profitability.
ABSTRAK

Kajian ini mengkaji kesan pengurusan modal kerja ke atas keuntungan perusahaan kecil dan sederhana (PKS) di Malaysia dengan menggunakan sampel 66 firma pembuatan PKS meliputi dari tahun 2006 sehingga 2012. Teknik regresi Ordinary Least Squares (OLS) digunakan untuk menganggarkan hubungan di antara pembolehubah bebas dan bersandar. Hasil kajian menunjukkan bahawa, terdapat hubungan negatif di antara komponenkerja modal iaitu hari akaun belum terima (DAR), hari pusing ganti inventori (ITID), dan kitaran penukaran tunai (CCC) dengan keuntungan PKS yang diukur menggunakan pulangan atas aset (ROA) dan pulangan ke atas ekuiti (ROE), kecuali keuntungan operasi bersih (NOP) yang mempunyai kesan positif dengan CCC. Di samping itu, hasil kajian menunjukkan bahawa terdapat hubungan yang positif di antara hari akaun pembiayaan (DAP) dengan ROA dan ROE, tetapi di sebaliknya, DAP mempunyai hubungan yang negatif dengan NOP. Ini menunjukkan bahawa keuntungan firma pembuatan PKS bergantung kepada pengurusan modal kerja yang berkesan. Oleh itu, kajian ini mencadangkan bahawa syarikat-syarikat pembuatan PKS boleh meningkatkan keuntungan mereka dengan mengurus modal kerja dengan betul.

PERKATAAN PENTING: Modal kerja, pengurusan modal kerja, pembuatan Sektor, Malaysia, PKS, keuntungan.
ACKNOWLEDGEMENT

First and foremost, thanks to Allah S.W.T whom with his willing gives me the strength and opportunity to complete this thesis to fulfil the requirement of Master of Science Finance at Universiti Utara Malaysia. Secondly, I am heartily thankful to my supervisor Dr. Azira Abdul Adzis for her patience, assistance, encouragement and guidance for correcting in order to complete my thesis. Her guidance helped me in all the time of research and writing of this thesis. I would also like to thank Dr. Hanita Kadir and Dr. Khaw Lee Hwei for their feedbacks. Their commitment and time spent for this thesis is most appreciated.

Thirdly, I would like to express my sincere gratitude to my parents for their endless love, utmost assistance (financially and mentally) and prayers throughout my life, may Allah grant them long life, health and prosperity, amin. And all my family members for their source of inspiration and motivation. To them I dedicated this thesis.

I also want to take this opportunity to thank to Companies Commission of Malaysia (CCM) for their speedy response in providing the data used in this study.

Last but not least, thanks to all my friends, my colleagues and my lecturers, those have been contributed by supporting my work throughout my study.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>TITLE PAGE</td>
<td>ii</td>
</tr>
<tr>
<td>CERTIFICATION OF THESIS WORK</td>
<td>iii</td>
</tr>
<tr>
<td>PERMISSION TO USE</td>
<td>iv</td>
</tr>
<tr>
<td>ABSTRACT (ENGLISH)</td>
<td>v</td>
</tr>
<tr>
<td>ABSTRAK (BAHASA MELAYU)</td>
<td>vi</td>
</tr>
<tr>
<td>ACKNOWLEDGEMENT</td>
<td>vii</td>
</tr>
<tr>
<td>TABLE OF CONTENTS</td>
<td>viii</td>
</tr>
<tr>
<td>LIST OF TABLES</td>
<td>xi</td>
</tr>
<tr>
<td>LIST OF FIGURES</td>
<td>xii</td>
</tr>
<tr>
<td>CHAPTER 1: INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>1.1 Background of Study</td>
<td>1</td>
</tr>
<tr>
<td>1.2 Overview of SMEs in Malaysia</td>
<td>2</td>
</tr>
<tr>
<td>1.3 Problem Statement</td>
<td>5</td>
</tr>
<tr>
<td>1.4 Research Questions</td>
<td>7</td>
</tr>
<tr>
<td>1.5 Research Objectives</td>
<td>7</td>
</tr>
<tr>
<td>1.6 Significant of Study</td>
<td>7</td>
</tr>
<tr>
<td>1.6.1 Practical Contribution</td>
<td>8</td>
</tr>
<tr>
<td>1.6.2 Theoretical Contribution</td>
<td>8</td>
</tr>
<tr>
<td>1.7 Scope of the research</td>
<td>8</td>
</tr>
<tr>
<td>1.8 Organisation of the Thesis</td>
<td>8</td>
</tr>
<tr>
<td>CHAPTER 2: LITERATURE REVIEW</td>
<td>10</td>
</tr>
</tbody>
</table>
2.1 Introduction

2.2 Theoretical discussion

2.2.1 Working capital policies
    2.2.1.1 Moderate policy
    2.2.1.2 Conservative policy
    2.2.1.3 Aggressive policy

2.2.2 Working Capital components
    2.2.2.1 Trade Receivables
    2.2.2.2 Inventory Management
    2.2.2.3 Account Payables Management
    2.2.2.4 Cash Conversion Cycle

2.3 Review of Previous Empirical Result

2.4 Theoretical Framework

2.5 Hypothesis Development

CHAPTER 3: RESEARCH METHODOLOGY

3.1 Introduction

3.2 Data

3.3 Sample

3.4 Definitions of terms used

3.5 Variables Measurement
    3.5.1 Dependent Variables
    3.5.2 Independent Variables
    3.5.3 Control Variables

3.6 Techniques of Data Analysis
    3.6.1 Models
## CHAPTER 4: RESULTS AND DISCUSSION

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.1 Introduction</td>
<td>35</td>
</tr>
<tr>
<td>4.2 Descriptive Statistics</td>
<td>35</td>
</tr>
<tr>
<td>4.3 Pearson Correlation</td>
<td>37</td>
</tr>
<tr>
<td>4.4 Regression Analysis</td>
<td>41</td>
</tr>
<tr>
<td>4.4.1 Return on Asset as Measure of Profitability</td>
<td>42</td>
</tr>
<tr>
<td>4.4.2 Net Operating Profit as a Measure of Profitability</td>
<td>43</td>
</tr>
<tr>
<td>4.4.3 Return on Equity as a Measure of Profitability</td>
<td>44</td>
</tr>
</tbody>
</table>

## CHAPTER 5: CONCLUSION AND RECOMMENDATION

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.1 Summary of the study</td>
<td>46</td>
</tr>
<tr>
<td>5.2 Implications of Study</td>
<td>46</td>
</tr>
<tr>
<td>5.3 Limitations of the Study</td>
<td>47</td>
</tr>
<tr>
<td>5.4 Recommendation for Future Research</td>
<td>48</td>
</tr>
</tbody>
</table>

## REFERENCES

Page 49

## APPENDIXES

Page 59
# LIST OF TABLES

<table>
<thead>
<tr>
<th>TABLES</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 3.1 Sample of the firms</td>
<td>27</td>
</tr>
<tr>
<td>Table 3.2 Dependent variables</td>
<td>29</td>
</tr>
<tr>
<td>Table 3.3 Independent variables</td>
<td>30</td>
</tr>
<tr>
<td>Table 3.4 Control variables</td>
<td>31</td>
</tr>
<tr>
<td>Table 3.5 Expected sign of each variable</td>
<td>34</td>
</tr>
<tr>
<td>Table 4.1 Descriptive statistics</td>
<td>36</td>
</tr>
<tr>
<td>Table 4.2 Pearson correlation</td>
<td>39</td>
</tr>
<tr>
<td>Table 4.3 Multicollinearity</td>
<td>40</td>
</tr>
<tr>
<td>Table 4.4 Regression analysis</td>
<td>42</td>
</tr>
</tbody>
</table>
## LIST OF FIGURES

<table>
<thead>
<tr>
<th>FIGURES</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 1.1 Constraints faced by SMEs</td>
<td>4</td>
</tr>
<tr>
<td>Figure 2.1 Cash conversion cycle process</td>
<td>15</td>
</tr>
<tr>
<td>Figure 2.2 Research Framework</td>
<td>23</td>
</tr>
</tbody>
</table>
CHAPTER 1
INTRODUCTION

1.1 Background of Study

Working capital deals with the financial health of a company and it also plays important role in maximizing the shareholders wealth, hence, every company needs to sustain the balance between liquidity and profitability. Liquidity is a requirement to ensure that the firm is able to meet its short-term obligations (Deloof, 2003; Padachi, 2006). Working capital comprises the most liquid assets and it can be defined as the difference between current assets and current liabilities (Paramasivan and Subramanian 2009). Thus, the relationship between current assets and current liabilities are the main theme of the theory of working capital management.

Talat and Nazir (2011) & Smith (1980) highlight that short-term assets and liabilities are important components of net working capital and therefore needs to be carefully analysed, since they play a key role for firm’s profitability, risk, as well as its value. Indeed, companies might have an optimal level of working capital that counterbalances the costs and advantage of holding working capital and also maximizes their profitability or value (Afza & Nazir, 2007; Deloof, 2003).

According to Padachi (2006), company has efficient working capital when their current assets are higher than its current liabilities. This explains that the company is able to continue its operations and also has sufficient fund to fulfil its short-term obligations and upcoming operational expenses (in other word, the notion of working capital management explains how companies’ manage their current assets and current liabilities to improve both liquidity and profitability). A proper management of working capital encourages a company’s well-being in the market and also helps
The contents of the thesis is for internal user only
References


Hong Yuh Ching, Ayrton Novazzi & Fábio Gerab (2011). Relationship between working capital management and profitability in Brazilian listed companies, journal of global business and economics, volume 3.


