FACTOR INFLUENCING IMPACT OF CORPORATE GOVERNANCE ON WORKING CAPITAL MANAGEMENT: CONCEPT PAPER

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Abstract - According to a SME’s Annual Report, the vast majority of company (93%) view working capital management as a crucial contributor to the financial sector's effect over the next five years. This has certainly changed the economy, technology, and politics in various aspects of business. This financial revolution affects almost all industries, especially in Malaysia. This article focuses on Malaysia's to understand the factor influencing in working capital management for establishing in future. The factor study in three categories: (1) CEO Tenure, (2) Board Size, and (3) CEO Duality. A conceptual framework was formed on the factors influencing in Malaysia by using the Agency Theory. This study aims to establish a relationship between Malaysia's working capital management.

Keywords - CEO Tenure, CEO Duality, Board Size, Working Capital Management Agency Theory.

I. INTRODUCTION

In financial management, corporate governance and working capital management (WCM) are treated as a very important subject (Abbas, et al., 2019). However, many researchers studied on the influence of corporate governance but only few of them connecting it with working capital management (WCM) efficiency (Ahmad, et al., 2018). Particularly in Malaysia, there has been little concentration given on the relationship between corporate governance attributes and WCM of the companies. Many studies focus on relationship between working capital management and firm’s performances rather than the corporate governance’s perspective. Unfortunately, inefficient management of working capital encouraged by inadequate governance practices has a negative effect on the wealth of shareholders (Abbas et al., 2019).

Therefore, the present study intends to analyze the impact of corporate governance represented by CEO tenure, CEO Duality, Board size and Audit committee on WCM represented by current ratio and cash conversion cycle of 35 Selangor based companies which are listed under FTSE Bursa Malaysia Top 100 Index. These companies were identified as Selangor based companies by observing its principal place of business, business address, head office, headquarters, and corporate office. This research extends the work of Gill & Biger, (2013) and Ahmad et al., (2018) which suggested future researchers to investigate the generalization of their study beyond American manufacturing firms and Pakistan listed firms.

Research is expected to avail the owners of the firms to improve their corporate governance practices to enhance WCM efficiency and furthermore, contribute to enhancement of profitability of the firms and maximizing shareholder’s wealth indirectly.

Additionally, the discussion from this study also can be a guidance of good corporate governances’ criteria that significantly affect the efficient of WCM to be practiced by other companies including the SMEs and other organizations especially in Malaysia.

II. BACKGROUND OF THE RESEARCH

In manufacturing companies, working capital is expected to affect the company's profitability. It can be seen from the operating activities of companies started from capital investment to supplies the raw materials of its products and their receivables and pay for the debts of the company. The manufacturing company is a company that produces the needs of society in Malaysia both as an industry that produces goods to satisfy basic needs also generates additional needs. Inventory is an asset to manufacturing company, since the inventory is a major source of income in these types of companies. Manufacturing companies must store enough supplies to meet the needs of its customers. Failure on this account would be bad if it was not considered seriously, because it can result in loss of sales / revenue so as to reduce the company's operating profit.

This research adopts previous research conducted by Akoto, Vitor, & Angmor (2013) who studied the effect of working capital management on profitability in the manufacturing industry listed in Ghanaian Stock Exchange 2005-2009 consist of the dependent variable is the return on equity to measure profitability, independent variables; number of days’ accounts receivable, number of days’ accounts payable, cash conversion cycle, & current ratio. And the control variable is the size of the company and current assets turnover. Prior research done by Falope and Ajilore (2009) found a significant negative relationship between net operating profitability and the average 5 collection period, inventory turnover in days, average payment period and cash conversion...
cycle for a sample of fifty Nigerian firms listed on the Nigerian Stock Exchange. In this study, the selected factors as an object of research are the manufacturing industry. Because the company is considering ideal in working capital management. In manufacturing companies, it can be seen from the operating cycle that involves investment in inventories and receivables and make the payments on their debts. In particular, the manufacturing industry associated with supplies. Based on the above mentioned argumentation, this study observed the impact of working capital management company in Malaysia.

III. PROBLEM STATEMENT

Many researchers focus on the effect of efficient working capital towards the firm’s profitability (Kamel, 2016 as cited by C. R. et al., 2018). However, it is very important to identify the factors that make working capital of the firms being managed efficiently and that, in return, result in its profitability. One of the factors which contributes to it is corporate governance.

Corporate governance influences the financial development through operating management of finances to the capital market. Chaudhry & Ahmad, (2015) revealed that corporate governance practices have a significant influence on WCM where it can improve the implementation of it. Achchuthan & Kajananthan, (2013) suggested that the efficient policies in the WCM must be worked out through the corporate governance practices.

However, there is less evidence about the effect of corporate governance on the efficiency of WCM in previous literatures (Chaudhry & Ahmad, 2015). Many researchers studied on the impact of corporate governance but very few of them stress on its impact on WCM efficiency (Ahmad et al., 2018). Additionally, the corporate finance literature has traditionally focused on the study of long-term financial decisions, such as investments, capital structure, dividends, and company valuation decisions (Kasiran, Mohamad & Chin, 2016) rather than the short-term which represent the WCM. One of the crucial components in WCM is liquidity measure, hence the focus on conversion cycle and current ratio is indispensable. Liquidity is very important to measure survivability of the firms in the short-term, especially during such nowadays crisis or pandemic.

Furthermore, this topic is very rare and almost untouched in Malaysian’s perspective. Many studies in Malaysia focus on relationship between working capital management and firm’s performances (see AIK & Tee, 2019; Al-Mawsheki et al., 2019; Zariyawati et al., 2016) rather than the corporate governance’s perspective. Besides, previous studies found inconclusive results on this topic. For examples, C. R., J. Mbekomize, Mapharing, & Selinkie (2018) and Ahmad et., al. (2018) found that corporate governance mechanisms have a significant impact on working capital management while Achchuthan and Kajananthan, (2013) and Kamau & Basweti, (2013) revealed that there is no significant mean different between the levels of working capital management efficiency among corporate governance practices. Due to lack of study on this topic particularly in Malaysia’s context, it is highly crucial for this study to conduct intensive research to provide sufficient evidence to this a literature.

IV. THE GAP OF RESEARCH

Efficient working capital management helps maintain smooth operations and can also help to improve the company's earnings and profitability. Management of working capital includes inventory management and management of accounts receivables and accounts payables. The main objectives of working capital management include maintaining the working capital operating cycle and ensuring its ordered operation, minimizing the cost of capital spent on the working capital, and maximizing the return on current asset investments (Ahmad et al., 2018). In this study, researcher to identify the factor influencing impact of working capital management. A few study was done in Malaysia. This study also identified factor such Ceo Tenure and Board Size it is effected to working capital management. It is important to review this since it is enforcing under Company Act 1976.

V. LITERATURE REVIEWS

5.1. Agency Theory

The study employed the agency theory to give a clear view of the relationship between boards characteristics and WCM efficiency. Agency theory is developed to define the relationship between the shareholders or board of directors (principals) and managers (agents). The theory suggests that the objectives of both the agents and principals in the company should be matched. Unaligned objective between agents and principals will constitute an agency problem (Purag, Abdullah, & Bujang, 2016). This problem occurs due to conflict of interest between both parties. Agency theory also highlights the importance of boards’ institution for mitigating the agency problem in the companies. The findings of this study are anticipated to create attention and perception to the policy maker and the top management that formulating the good corporate governance will influence the efficient WCM. The WCM will have a very significant impact on the profitability of the firms (Ng, Ye, C., Ong, & Teh, 2017).Thus, effective WCM will indirectly result in enhancement of companies’ profitability and boost the shareholders’ wealth. Additionally, the
maximization of shareholders’ wealth is an indicator of reduction and elimination of agency problems in the companies.

5.2. Board size
According to Coleman, Woo and Baidoo (2020), a larger board size is seen as the one with various expertise and diverse experience and knowledge to enabling proper decision-making that enhances better firm performance than a smaller board size. Hence, manufacturing firms can improve their working capital management efficiency by increasing their board size (Chaudhry & Ahmad, 2015). However, Kamau & Basweti (2013) found that there is insignificant positive relationship between board size and WCM efficiency. They suggest that the size of the board has no significant impact on the levels of working capital management of a firm. Similarly, C. R., J. Mbekomize, Mapharing, & Selinke (2018) found that board size had a non-significant negative low impact on current ratio. However, they also discovered that board size had significant negative impact on cash conversion cycle. Furthermore, Gill & Biger (2013) found a negative relationship between board size and cash conversion cycle and between board size and current ratio which in turn indicate board size does not improve cash conversion cycle. Additionally, the observe that larger board size may not be in favor of American manufacturing firms because it does not improve working capital management efficiency.

Abbas et al., (2019) stated that board size is positively related to cash conversion cycle which indicates increase in board size will extend the cash conversion cycle of the firms. They presumed that the possible explanation of this positive relationship is that to increase sales, the board of directors may formulate soft credit policies for customers which results in an increase of average collection period and this increase in collection period leads to an extension of the cash conversion cycle. Similarly, Ahmad et al., (2018) observed a positive relationship between board size and cash conversion cycle and between board size and current ratio, which indicating the fact that larger boards increase the liquidity of the firms. They also depict that when the size of the “board members” increases, it also increases the cash conversion cycle therefore decreasing profitability. This study further contributes to the literature by suggesting that the size of the board members must not be very large because larger board size reduces the efficiency in controlling and monitoring and small board size increases the efficiency in the management of working capital.

5.3. CEO Tenure
Gill & Biger, (2013) found a non-significant relationship between CEO tenure and cash conversion cycle and positive relationships between CEO tenure and current ratio. They indicated that when a CEO serves longer in a firm, he or she has a positive influence on working capital management efficiency. Furthermore, Ahmad et al., (2018) found a significant negative relationship between CEO tenure and cash conversion cycle between CEO tenure and current ratio. They state that more experience of the CEO tenure leads to the efficiency of managing organizational resource and the longer the CEO serving in firm, the more protection they will give to the interest of the shareholders. Additionally, they conclude that CEO with longer tenure have more understanding of the dynamic nature of the organization and are in a better position to set policies that will benefit the firm. However, Kamau & Basweti (2013) found that CEO tenure was found to have a positive but weak relationship with the levels of working capital management efficiency. They suggest that CEOs who serve for a long term are only able to moderately improve the levels of working capital management efficiency of a company.

5.4. CEO Duality
Generally, CEO duality exists when a board member holds the position of CEO in the same company (Ahmad et al., 2018). Coleman et al., (2020) stated that better decisions are taken with clarity and understanding and allow for proper policy making and monitoring when there is no duality role of the CEO. Additionally, they stated that CEO duality improve the efficiency of accounts receivable management, which in turn help reduce working capital requirements.

On the contrary, Gill and Biger (2012) found a non-significant relationship between CEO duality and cash conversion cycle and between CEO duality and current ratio. This is supported by Ahmad et al., (2018) where they found a non-significant positive relationship between CEO duality and cash conversion cycle and between CEO duality and current ratio. They suggest the non-significant are due to different organization has different requisition of corporate governance practices.

5.5. Working Capital Management
In this context, the working capital is known as life giving force for any economic unit and its management is considered among the most important function of corporate management. Therefore, every organization whether, profit oriented or not, irrespective of size and nature of business, requires necessary amount of working capital.(Achchuthan and Kajananthan, 2013). Cash conversion cycle and current ratio are the main measures of WCM efficiency (Ahmad et., al 2018). Cash conversion cycle is considered as key measure to determine the efficiency in working capital management (Achchuthan and Kajananthan, 2013) while current ratio always been used as measure of corporate liquidity conventionally (Zariyawati, Annuar, Taufiq and Abdul Rahim 2009)
Gill and Biger (2012) study on relationship between characteristics of corporate governance on various characteristics of working capital components and measures of efficiency on selected of 180 American manufacturing firms listed on the New York Stock Exchange (NYSE) for a period of 3 years (from 2009-2011) have found out that inefficient working capital management policy, induced by poor corporate governance, has a negative impact on shareholders’ wealth. In ascertain the relationship between governance characteristics and WCM efficiency, Ahmad et., al (2018) used data of 40 firms listed at Pakistan Stock Exchange for the period of 5 years developed a total of eight hypotheses to examine the significant relationship between governance characteristics and WCM efficiency. The results state that governance characteristics have significant impact on WCM efficiency.

VI. THE PROPOSED OF CONCEPT FRAMEWORK

To understand the study, a conceptual framework is necessary. A conceptual framework integrates research into important knowledge bases, providing the groundwork for the issue statement and research questions to be significant (Yusoff et. al., 2022). As mentioned above, this study aims to focus Malaysia’s potential for factor influencing impact of corporate governance as a means of supporting the economy and establishing a new way of challenge. Based on the literature review of this study, the conceptual framework is shown in Figure 1.

![Figure 1: Factor Influencing Impact of Corporate Governance on Working Capital Management.](image)

Figure 3 illustrates the factors that drive the impact of corporate governance on working capital management in Malaysia. The perceived usefulness of new relationship is crucial to influencing working capital and it is contributing a new challenge in capital management. The conceptual framework for this study has been built on the basis of the link established by previous researchers. It covered variables such as Board Size, Ceo Tune and Ceo Duality in relation to the rise of working capital management in Malaysia, as shown in Figure 1.

VII. RECOMMENDATIONS AND LIMITATIONS

Working capital has its own importance for the operational efficiency, success, and growth of every company but, in the case of SME, its management is quite important because these companies always lack in working capital. SME are playing a great role in the economic and social development of Malaysia but, these companies are facing a lot of challenges in increasing their working capital by gaining finance from financial markets. To overcome these challenges, managerial skills are needed to develop by SME or government support is needed in this regard. The government of Malaysia is making a lot of effort in this regard by providing finance but, long-term and at a high cost. Some changes should be made in the policies of SME financing so that they will easily increase their working capital to run business operations for current success and growth. The limitation of study is that it omits a few major financial and investment transactions. Important information regarding changes in the resources of the firm and in the financial structure of the firm are omitted. It is too challenge to get financial report from the SMEs company in Malaysia, especially company under private limited.

VIII. CONCLUSION

The findings from this study also can be a guidance of what are the good corporate governances that significantly affect the efficient of Working Capital Management to be practiced by other companies including the SMEs and other organizations especially in Malaysia. According to the SME Annual Report or known as SME Insights 2019/20, Selangor has been reported as highest number of SMEs establishment (179,271 establishments), representing 19.8% of total establishment of SMEs in Malaysia as stated in the SME Annual Report or known as SME Insights 2019/20. Therefore, this might be a benchmark and pioneer research study towards the Malaysian’s SMEs perspective in future. Furthermore, the study also contributes to the existing literature on the topic. The findings will serve future researchers to acknowledge the relationship between corporate governance practices and working capital management efficiency in Malaysia context. Finally, the study will also benefit the stakeholders and prospective investors by describing critical governance components to effectiveness of companies’ WCM.

From study, it is expected to inform management regarding the fundamental relationship between corporate governance mechanisms and working capital components. Moreover, the study will point management and policy makers to critical components of corporate governance and working
capital which they should concentrate on when formulating policies that can lead to suitable working capital management policies.

ACKNOWLEDGEMENTS

The Authors would like to express their gratitude to the UniversitiTeknologi MARA, Malaysia, for funding and facilitating this research project under the DUCS grant (Dana UiTM Cawangan Selangor).

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