THE ANALYSIS OF WORKING CAPITAL MAINTENANCE EFFICIENCY: IS IT STILL RELEVANT?

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ABSTRACT

In this new industry era, the use of working capital is very fragile. There are many old theories that by using working capital shorter cash conversion, credit period, inventory period, and the longer debt returning time, those points will increase the finance performance of the company. Unfortunately, the result of this study show the contrast as not all condition could accept the theories. The study uses documentation method by collecting recent literatures of the use of working capital in big companies and small and enterprise business. The type of study is qualitative as it will compare the recent literatures into the old theories. The result shows that the recent manufacture companies and small and medium enterprise against the theory. there is a significant speculation on a certain level from the need of working capital, it will make the company achieve returning point.

Keywords: *working capital, manufacturer company, small and medium enterprise*

INTRODUCTION

The efficiency of working capital management is the primary and important strategy in running general company strategy in order to increase the value of stakeholders or company Gitman andZutter,2012:600). The efficient use of working capital means that it reaches the stability point of infestation, it means that the optimum and ideal working capital use had been achieved (Charitou,2012:63). The ideal use of working capital management will result in quick respond performed by the company toward the economy wheel movement and it will gain advantage over its competitors (Ching*, et al,* (2011:74). The optimum use of working capital is caused by the decision making trust that it will bring long term benefit of finane performance for the company. In the other hand, the insolvency financial distress will be occurred if the company failed to manage the working capital that will lead to bankruptcy.

The management of working capital efficiency will help to stabilise profitability and risk optimally. The stability will be achieved as the continuing supervision is held from working capital components, they are: cash or cash equivalent, credit, inventory and debt. Even, the efficient working capital becomes basic point while implementing the strategy to increase the stock value which is represented to the company value (Deloof, 2003 :573). Stock value is a fair price as it is commenced by the dealt between offer and demand. Thus, it could be used as value proxy of the company (Wijaya, *et al* (2010:2).

Tight competition affects the price and profit margin, in the other side, company needed cash to make expansion in technology, new products, or to pay the debts. That is why, the finance manager turns to working capital as new source of finance. (Ching*, et al,* (2011:75).

The optimising struggle of company which is reflected in stock value is achieved through the implementation of finance management function, then it affects the company's value (Husnan and Pudjiastuti, 2015). The recent literature mainly focus on the long term finance decision which are infestation, capital structure decision, dividend decision, and company's value decision (Sadiamajeed, et al, 2013:36; Teruel and Solano, 2007:164). In the last two decades,

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the development of new working capital management had started (Sadiamajeed, *et al*, 2013:36).

The efficient working capital is determined by current and liability asset management. It needs a continuing supervision in order to maintain the several components of working capital. Especially, it is for the manufacturer company that more than fifty percent of its current asset from total asset of the company (Gitman andZutter, 2012).

Working capital is very important, but in practical, it is not commonly mentioned in decision making process because it is short term infestation and finance (Sadiamajeed, *et al*, 2013:80).

In managing the working capital, it s very important to keep the liquidity in order to ensure the operational activity is in normal procedure and able to fulfil the liability's company (Eljelly, 2004:48). The duty of finance manager is hard enough as they must maintain the business operation efficient and profitable. There might be no synchronisation between current and liability asset. If the manager could not stabilise of both assets, it will affect the development and profitability of the company.

The efficient working capital management ensures the company's cash flow to execute the operational in normal procedure and minimise the risk. Though, the capital improvident must be voided as it will create opportunity cost that would reduce profit value. Working capital management is blood stem of the company and the manager is being responsible to maintain the cash flow in order to make profit (Saghir, 2011:1003).

Generally, the working capital management indicator is cash conversion cycle and net trading cycle which is dynamic approach and static current ration approach (Sadiamajeed, *et al*, 2013:36). The study uses cash conversion cycle and net trading cycle and its components to measure the value of working capital management efficiency within its relevant in achieving the profitability and company's value.

The internal and external company's value will affect the efficiency of working capital management (Manoori and Muhammad, 2012:16-17). The internal variables are frm's size, sales growth, leverage. Through this study, those variables will be analysed within working capital efficiency, it will reveal the relevant value of its finance performance of the company.

The study that analyse the impact of working capital efficiency towards finance performance shows inconsistency result. Working capital management has both positive and negative impact toward profitability of the company. Thus, the theory that said there is a significant impact between working capital efficiency and finance performance remains opaque. There is a possibility in significant level from the working capital need will enhance the recovery level of the company (Gill *et al*, 2010:2)

Most of the previous study's result found negative impact between working capital management and profitability. Those studies are occurred in *Karachi Stock Exchange* of Pakistan (Anser and Malik, 2013;Sadiamajeed, *et. al*, 2013) *Abu Dhabi Securities Exchange* of Kuwait (Naser*, et. al*, 2013);Malaysia(Mohamad and Saad, 2010); Thailand(Napompech, 2012); Srilanka (Jayarathne, 2014);Nigeria(Uwuigbe*et al*, 2012);; Indonesia (Martha andJanuarti, 2013), Nairobi Securities Exchange of Kenya (Nzioki et al, 2013); Jordan (Abuzayed, 2011, and Malaysia (Azhar and Noriza, 2010). Similar results are found in developed country such as Singapore (Manoouri and Muhammad, 2012),United State of America (Gill, *et al*, 2010), Belgium (Deloof, 2003) and some companies in Europe (Garcia*, et al*, 2011).

Differ from studies in Indonesia Charitou, *et, al* (2012), Widyastuti, et. al (2017), it does not support the working capital efficiency toward the profitability, because the longer asset

infested in working capital, the higher profitability is. The similar result occurred in Pakistan (Tariq, *et, al* (2013), Nigeria (Ogundipe, 2012), Nigeria (Akinleye, *et al*, 2012), Turkey (Vural *et al*, 2012) and some marketplace of developed country such as USA (Gill, *et al*, 2010).

The studies that result in negative impact between working capital management and finance company indicates that the companies apply the working capital efficiency management. It could be revealed from the short term of cash flow cycle affects the increasing profitability and company's value, and vice versa. The studies that result in positive impact between working capital management and finance company must reconsider another experiment in order to find the causes by analysing the previous studies.

Thus, the study entitled 'The analysis of working capital maintenance efficiency'. And the study analysed the recent literature toward the previous studies from 2003-2017.

Table 1. The variables of working capital efficiency

Variable	Concept	Efficiency's Criteria
Gross Profit Margin (GPM)	Gross Profit/ Net Sales	+
Net Profit Margin (NPM)	Earning After Tax/Net Sales	+
Return On Asset (ROA)	EBIT/Total assets	+
Return On Equity (ROE)	EAT/Total Shareholder Equity	+
Tobin's Q	(Market Value Outstanding Share +Debt)/ Firm's Asset	+
Price Book Value (PBV)	(Per page asset value of market)/Book's Value	+
Average Collection Period (ACP)	(Accout Receivable/net Sales) x 365	-
Inventory Turnover in Days (ITD)	(Inventory/CGS) x 365	-
Average Payment Period (APP)	(Account Payable/CGS) x 365	+
Cash Conversion Cycle (CCC)	ACP+ITD-APP	-
Net Trading Cycle	ACP+(Inventory/Net sales*365)-(Accouts Payable?Purchases*365)	+
Firms's Size (Size)	Log Natural Size	+
Sales Growth	(Sales $_{t}$-Sales $_{t-1}$) Sales $_{t-1}$	+
Financial debt Ratio	Total Financial Debt/Total Aset	-

Source: Several literatures and Journals

Note: (+) Positive Impact toward Efficiency; (-) Negative impact toward Efficiency

DISCUSSION

Working Capital Management Theory

Working capital management is about managing the current and debt asset and the cost of it (Gill *et al*, 2010:1). When the decision on finance is managing the company's resource in less than a year, it is called short term financial management (Gitman and Zutter, 2012:600). Managing working capital is meant to control current and debt asset of the company in order to create a stabilisation between profit and risk toward the positive value of the company (Kaur andSingh, 2013:197; Gill *et al*, 2010:2; Vural et al, 2012:489; (Gitman andZutter, 2012:600).

Theoretically, there are two concepts of working capital which are gross and net working capital (Uremadu *et, al* 2012:83). First, gross working capital is total amount of current asset. Current assets are cash, short term securities, credit, and inventories. Second, net working capital is deviation between current and debt assets. Debt asset are over exceeded claim in

one year, debtor, supplier demand, and costs from debt, negative or positive net working capital. It will be negative if the debt asset is bigger than current asset (Uremadu, *et, al*, 2012:83) and (Gitman and Zutter, 2012:601).

From management perspective, both concepts have same intention. Gross working capital focuses on two aspects which are: 1) the first aspect uses current asset optimally, 2) the second aspect is current asset finance. The first aspect is meant to avoid two dangerous points: over infestation and overload. The overload infestation could decrease profitability. In the other hand, the over infestation will create solvability or the inability of company to pay its debts. The change of acivity of the company affects the fluctuating working capital. In that situation, management must reconsider their stability to achieve the efficiency value Uremadu, 2012:83).

Another aspect of gross working capital is that the finance management is occurred as a result of increasing business activity. If there is any over budget, it must be immediately infested to avoid static fund. The overload working capital will decrease the profit value for the company. In the other hand, less working capital will interrupt production process that will also decrease the profit value (Uremadu, 2012:82).

The finance manager must be able to stabilise the position of working capital continuously to keep the liquidity in order to minimise risk and increase the profit value (Vural *et al*, 2012; Uremadu, 2012:82). Thus, it will create optimum balance between working capital components as main objective (Gill, 2011; Vural *et al,* 2012).

In order to maximise the working capital to gain more profit and company's value, the concept of gross working capital are as important as the net working capital (Deloof, 2003:573). To expect the exact vaue of working capital, every company must be analysed properly. In reality, the current asset does not only come from short term debt, but it is the combination of long term and short term deposit. Because, the current asset creates cost of capital that it must be productively used (Uremadu, 2012:84).

The Working Capital Efficiency Relevancy: Previous Study Result

There had been many previous studies that test the cash conversion flow effect towards the finance performance of company, the results are varies. Some previous studies support the theory of efficient money management, but some previous studies show the contrast that relevancy of working capital is responsible for increasing the company's value and performance.

Study by Roheman,*et.al* (2010) in 2004 the manufacturer listed on Karachi Stock Exchange in Pakistan found that cash conversion flow, credit gather period, and inventory cycle affect significantly negative toward the profitability measured by Net Operating Profit (NOP); contrary, the debt cycle period give positive impact toward profit value. The result supports study conducted by Kaddumi and Ramadan (2012) who commence experiment on 49 companies in Jordanian in 2005-2009; by using Net operating profit and recent asset. The result support the theory of working capital management theory, the shorter credit gathering period, inventories, and cash conversion cycle are, the longer debt period will be that will impact on increasing value of profitability. Thus, the company will be able to increase the efficiency of working capital. The efficiency of working capital is in line with the company's value that will increase sales confirmation and profitability. Those efficiencies is more significantly used on the variables of firm's size and sales development, it is negative and positive leverage Nzioki, *et al*, 2013; andAbuzayed , 2011).

Research during 2001 - 2010 used a random sample of industries in the Jordanian market, Al-Debi'e (2011) shows the cash conversion cycle and its components have a negative influence

on financial performance (GPM). This study describes the longer period of cash conversion, period accounts receivable, inventory period and debt period will reduce the profitability of the company. The subsequent impact reduces the average inventory, the debt collection period, the debt repayment period and the cash conversion cycle will increase the profitability of the company. The results of this study are in line with the theory which says that the shorter the cash conversion cycle, the period of accounts receivable and the period of inventory have an effect on the increase in profits, and vice versa. An acceptable reason that debt payments have a negative effect on profitability is because the company has utilized the discount during the payment period determined by the supplier. The results of the above studies are in line with Ngwenya's research (2012 on 69 companies Listed on the Johannesburg Stock Exchange (JSE) and Karaduman, et. Al. (2011) on Istanbul Stock Exchange. While the research of Makori and Jagongo (2013), found a negative and significant influence between the cash conversion cycle, net trading and its components with company financial performance (ROA). Using the 2003 period data - 2012 manufacturing companies that are Listed on Nairobi Securities Exchange (NSE), Mohammad and Saad (2010) also find the same effect as indicators of profitability is profit on assets (ROA) and firm value (Tobin's Q).

Those conducted previous studies as they use variable control within same experiment, the result is consistent which stated that firm's size and sales development has positive and significant impact toward profitability. The result indicates that company is successfully increase their income and it increases the working capital efficiency in order to increase the finance management. It is proven by the decreasing use of leverage to run the company; there is a significant effect between leverage toward the finance performance of the company.

The analysis using cash conversion flow as working capital efficiency measurement, there is a significant negative impact between cash conversion flow cycle and net trading cycle and profitability, as stated by (Gill *et al*., 2010) conducted by using 88 companies as subject of study listed on New York Stock of 2005-2007*,* Azam andHaider (2011) conducted study on Karachi Stock Exchange (KSE-30) of 2001-2010 and Ogundipe*, et al* (2012) conducted study on 54 companies within Nigeria Stock of 2000-2007 within dependant variable asset (ROA) and company's value (Tobin's Q). It is supported by the study conducted by Sunday, *et, al* (2012);Ashar andNoriza (2010) within company's value indicators (Tobin's Q) ;Sadiamajeed *et. al* (2013) studied 32 random manufacturer companies in Pakistan in 2006-2010 within return on asset ROA indicators, return on equity, and profit EBIT, and also study of Karadagli (2012) conducted in Turkey in 2002-2010.

However, the above research is not in line with the following research which shows a positive and significant influence between the cash conversion cycle, the collection period, the period of inventory turnover and the period of debt repayment with profitability and firm value. These results indicate that it is not in line with the theory that the shorter the collection period, the period of inventory turnover and the cash conversion cycle will increase profitability. This means that the longer the collection period, the period of inventory turnover, the period of debt repayment and the cash conversion cycle actually increases the profitability and value of the company. Such research was carried out by Akoto et. al (2012) in 13 companies in Ghana in the period 2005-2009 with the dependent variable return on equity (ROE), research by Ogundipe, et al (2012) on 54 companies that were Listed on Nigeria Stock period 2000-2007 on Nigerian exchanges with a dependent variable level return on investment (ROI). Garcia, et al (2011) on the European market, Charitou, et al (2012); Widyastuti et al (2017) on the Indonesian market, Ching, et al (2011) in the Brazilian market with indicators of profitability in return on assets (ROA). The same result was also found by Garcia, et al (2011) in European companies with indicators of profitability, gross

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income level (GOP), and research Sunday et, al (2012) in Nigeria with dependent variable return on investment / assets (ROI).

The discussion of the study stated that cash conversion flown and long net trading cycle will increase the sales and profitability. But, the profit will decrease within long cash conversion flow, if the working capital investment cost is higher than the longer inventories holder or the credit provider will be easier to the customers (Deloof, 2003:585 andGill*, et al*, 2010:1; Ogundipe, 2012; Tariq *et,al* (2013).

The condition indicates that the company possessed optimum working capital which has high trait of company's value. Bi inventories decrease the stock out risk and easier policy of credit will increase the sales development. Credit sale method will trigger the purchase as it makes the company being able to access higher quality products before paying them. (Raheman et al, 2010) stated that postponing paying the debt could be a new source of funding which is not expensive, more flexible, and able to access on higher quality products before fulfilling the debt. The postponing method could be an expensive method if the company offered early discount. With same line, it will increase the credit account and create problem for cash flow of the company.

Working Capital Efficiency For Small and Medium Enterprise

The management of working capital efficiency is also important for small and medium business for its continuity. Most of small business asset is current asset. Their main external fund comes from short term debt, and it has alternative external funding which is very limited, it makes them more independent in short term fund (Falope andAjilore, 2009:81). The next explanation about the difference of working capital efficiency of small and medium enterprise gives real prove about its effect toward profitability.

There many studies about this differences such as Teruel andSolano (2007) who use 8.872 small and medium enterprises in Spain in 1996-2002; next study is conducted by Falope andAjilore (2009) in 1996-2005 listed in *Nigerian Stock Exchange (NSE)* and study by Afeef (2011) in Pakistan that uses 93 small and medium enterprises in 2003-2008.

The result of Teruel andSolano (2007) study shows the ideal time limit for credit gathering, inventories cycle, debt returning time, and cash conversion flow range time, they have significant negative impact toward the returning asset. Meanwhile, the firm's size, the development sale affect positively on the profitability, leverage affects negative impact for finance performance.

Study by Afeef (2011) stated that cash conversion flow gives not significant negative impact toward Return of Asset, and the components of cash conversion flow has negative impact. The study by Falope andAjilore (2009:81) stated that the working capital variable affect finance performance significantly. Generally, the returning asset will decay over the time while the gathering credit, inventories cycle, and cash conversion flow take longer time. Meanwhile, the firm's size, the development sale affect positively on the profitability, leverage affects negative impact for finance performance. The result shows that working capital efficiency management of small and medium enterprise is as same as big company.

CONCLUSION AND RECOMENDATION

There are many theories said that the shorter cash conversion, credit period, inventory period, and the longer debt returning time, it will affect the finance performance, it is not always the same as expected on the field. On the contrary, the result of study stated that the longer cash conversion cycle, credit gathering period, inventory cycle, and te shorter debt retuning period, those will increase the finance performance. This condition is accepted in both small and big

business. This proves that the theories is not relevant enough in this current situation, there is a significant speculation on a certain level from the need of working capital, it will make the company achieve returning point ((Naser,*et. al*, 2013; Gill, *et al*, 2010:2), thus the working capital efficiency management will remain relevant to be analysed.

The result of study gives opportunity for feature researchers to conduct empirical study for either qualitative or quantitative studies within more variables and wider condition.

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