A CONCEPTUAL PAPER ON WORKING CAPITAL MANAGEMENT THEORIES

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Abstract-- Diverging from the underpinning of prominent decision-making in the corporate finance (e.g. investments, capital structure, dividends and corporate valuation) which possess the nature of long-term time period, working capital management (WCM) which monitoring and controlling the effectiveness of short-term assets and liabilities has deprived of decent attention from top management (PWC, 2017). Likewise, prior empirical findings have attested WCM as one of the most prominent yet least apprehend drivers (Losbichler & Mahmoodi, 2012). The prominent of WCM is evidenced having significant impact irrespective of the firms’ size, sector, industry, country as well as nature of the economy (Bhatia & Srivastava, 2016; Padachi, 2006). On the other hand, Palombini and Nakamura (2012) point out that the lacking of robust and well-adopted theories that are adequately comprehensive in explaining WCM. This paper stipulates essential working capital components (i.e. inventories, accounts receivable & accounts payable) which have been scrutinised to represent the length of cash conversion cycle as well as the level of working capital requirements. The organisation of this study is initiated with the delineation of the theories that are pertaining to the management of elements of short-term assets as well as liabilities, following by the depiction of the linkage between theorem and WCM components, in pursuance of the dual objectives i.e. profitability and liquidity.

KEYWORDS: Working Capital Management (WCM); Theories of WCM

1. Introduction

Working capital management is a forcible managerial judgment in pursuing the paradigmatic whereby counterbalance between risk and return. The succeeding literature has been explicated the exemplification whereby the long-term corporate financial decisions has gained more scrutiny in empirical groundwork as comparable with short-term decision-making such as working capital management (Almeida & Eid Jr, 2014). However, the situation might change in the contemporary time as evidenced by CFO Outlook Asia Survey (2015) ratifying that top financial personnel i.e. CFO and treasurers are no longer afford to disparage the prominent of working capital as the deposition of one-third of the respondents stating their prospect to having enhanced working capital management in order to increase the level of firms’ profitability.

Whereas developing nations such as Malaysia, with the emerging financial markets infrastructure, ought to require more devotion among the financial personnel regarding its short-term
operational efficiencies (Wasiuzzaman, 2015) as managing working capital is crucial regardless of the firms’ size, sector, industry, country as well as nature of economy (Bhatia & Srivastava, 2016; Padachi, 2006). Abundant of empirical and theoretical evidence has been attested that working capital management is critical to the long-term survival of any firms (Raheman, Afza & Qayyum, 2010; Padachi & Howorth, 2014), predominantly in the increasingly turbulent and complex business environment. The survival of businesses is threatened by the tightening of cash and credit supply (Mohamad & Saad, 2010), allegedly the businesses that making profits could go bankrupt owing to poor working capital management decisions particularly in the situation that is lacking competent in management of liquidity (Kieschnick, LaPlante, & Moussawi, 2012). Thereupon, financial managers are compelled to be competent in diagnosing which business activities that might be having substantial ramification in influencing the working capital management, wherein affecting the indicators i.e. profitability and liquidity (Ali & Haseeb, 2019; Haseeb, Abidin, Hye, & Hartani, 2018; Haseeb., 2019; Suryanto, Haseeb, & Hartani, 2018).

2. WCM Theories
This section depicts theories that are pertaining to the management of short-term assets as well as liabilities. In contrast to the intensity of both theoretical and empirical studies on firms’ long-term decision-making perplexity for instance capital structure, whereby negligibly past researches have been examining the influence of working capital from the point whether it is a relevant factor to be considered prior to determining the performance of a firm (Ukaegbu, 2014). Moreover, there is meager enlightenment on the optimum level of liquidity that ought to be maintained by firms in order to enhance firms’ profitability (Brealey, Myers & Allen, 2011, Ukaegbu, 2014). Palombini and Nakamura (2012) have been implied that there is no specific, robust and meticulously accepted theories have been able to independently explain the WCM except the Pecking Order (POT) and agency theories. Henceforth, it’s sensible for the researcher to delve into the postulations of prevailing theories in furtherance of better cognizance on efficiency WCM towards the firm’s performance through the attainment of dual objectives, profitability and liquidity.

Pecking Order Theory (POT)
Following the pecking-order logic, firms determine how to finance their investments in a defined order (Donaldson, 1961), to what degree utilisation of internal funds (i.e. retained earnings) in first place, followed by external funding (i.e. safe debt and then risky debt), and ultimately issuing of new equity (Fama and French, 2002). Successively, POT’s extension was attributed to the concept of asymmetric information between managers and investors (Lucas & McDonald, 1990). To this extent, managers are hypothetically equipped with relevant information about the fair value and its riskiness of the firm’s prospect as comparing with investors (Myers & Majluf, 1984). Precedent empirical researches have validated Myers’s proposition with the exposition of utilising internal funding could impel a greater degree of control on firms’ operations and assets utilization (Padachi, Howorth & Narasimhan, 2012). Henceforth there is a case wherein undervaluation of the firm’s real value prompting large firms to invest a higher amount in working capital requirements as they are presumed to have less information asymmetric issue (Haron & Nomran, 2016) to access external funding. The applicable of POT to working capital management could be conceived from the viewpoint of short-term financing decision, wherein Donaldson (1961) prevails upon the practice of firms to preserve a reasonable level of liquidity for the repayment of short-term obligation in arrears on top of mitigating disruptions along the operational business flow (Ajibolade & Sankay, 2013). As an indicator for working capital efficiency,
length of cash conversion cycle (CCC) has been identified as one of the prominent factors that affect the firm’s requirement for external funding (Soenen, 1993). The conventional practice indicates that the source of financing for the working capital requirement is predominantly deriving from long-term capital (Narasimhan & Vijayalakshmi, 1999), following by trade credit which is regarded as interest-free, short-term funding which conventionally embedded in the form of credit terms that offered by the suppliers. Nevertheless, the disputation arose by Ajibolade and Sankay (2013) asserting that in a circumstance of the limited internal source of funding wherein a firm that practices POT would choose to invest in long-term capital investments instead of working capital requirements, impelling the hindrance to achieve the optimality in managing WC components effectively.

Trade-off Theory
The dispute of working capital management has been undergoing an extensive researches which converging the addressing on the trade-off either upholding positive working capital (Gill, Biger & Mathur, 2010; Ali, 2010; Abuzayed, 2012) or negative working capital (Eljelly, 2004; Lazaridis & Tryfonidis, 2006; Garcia-Teruel & Martinez-Solano, 2007; Raheman & Nasr, 2007; Zariyawati et al., 2009; Mansoori & Muhammad, 2012; Wasiuzzaman, 2015) would enhance firm’s performance. Moreover, this argument could be delved further by scrutinising the financial implications between firms that possessing a substantial amount of working capital (i.e. large inventory and less stringent trade credit policy) and those have a minimal working capital level (i.e. lowest possible inventory level and strict trade credit policy). In light of high working capital investment, the firms might have to bear unnecessary inventory holding costs (Deloof, 2003), likewise increase the bad debt risk which would engender negative impact on firms’ profitability (Gill et al, 2010). Contrarily, low level of working capital might trigger loss of sales due to inadequate supplies as well diminishing the competitive edge as customers might switch to other traders whereby Ross et al. (2008) denotes it as the opportunity cost of margin i.e. the loss results from unable to offer acceptable credit terms.

As a matter of trading off risk-return, there are three approaches about working capital management in which comprising of aggressive, conservation and moderate strategies (Weinraub & Visscher, 1998), endeavour to strike a balance in between profitability, liquidity and solvency. As stipulated in the theory of risk and return, short-term investment with higher risk (i.e. having more short-term investments e.g. money market financial instruments) inclines to gain higher returns, along with liquidity risk whereby firms might experience a shortage of cash flow to cover operational expenditures. On the other hand, an investment with lower risk (i.e. holding more cash and more inventory are tied up with investment) might suffer lower returns (Lee et.al, 2016). Subsequently, finance managers are presupposed to maintain an optimal working capital portfolio whereabouts to weigh up their costs and benefits, consequently enhance the firms’ value (Aminu & Zainudin, 2015).

**Table 1: Theoretical proposition on trade-off between working capital components and its negative effect on essential objectives of WCM**

<table>
<thead>
<tr>
<th>Working capital component</th>
<th>Main objectives of WCM</th>
<th>Profitability</th>
<th>Liquidity</th>
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<tbody>
<tr>
<td>Cash</td>
<td>Holding excessive amount of cash would deteriorate profitability</td>
<td>• Holding excessive amount of cash would deteriorate profitability</td>
<td>• Undergoing cash shortage would induce liquidity problem whereby firms may</td>
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</tbody>
</table>
Agency Theory
Agency theory, the central theory that adopted to elucidate the conflicts within a business entity in the discipline of theoretical accounting, wherein Pinto and Augusto (2014) has grouped the succeeding studies into three types of conflicts which are shareholders and managers/directors; shareholders and the firm’s creditors (Jensen & Meckling, 1976); and expropriation issue arising between minority and large shareholders (Shleifer & Vishny, 1986). The theory denotes the relationship between principals (owners/shareholders) and agent (managers) in which the owners appoint managers to run the firm on their behalf (Jensen & Mecking, 1976; Jerzemowska, 2006). The pertinence of agency theory is interconnected with the engagement of financial managers in preparing their policies in dealing with different types short-term financial resources, coupled with the long-run financing decisions in order to fund various types of short-term assets. The theory further presumes that a firm’s manager presumptively to be a person that is capable to determine the optimum level of working capital, to be able to prepare a proper financial budget of a firm and minimising idle resources and hence enhancing shareholders’ wealth (Gill & Shah, 2012). Theoretically, efficient working capital management may lead to an increment in revenue, as assets are presumably able to generate additional returns on its investment subsequent paying off its short-term debt obligations. Therefore, finance managers should be susceptible on the determinants that affecting working capital management (WCM) due to the rationale of empirical evidence state that WCM has direct impact on the firms’ performance (Aktas & Petmezas, 2015). The owners of the company (i.e. shareholders) will be benefited from the excess revenue in
which will be treated as an income stream for shareholders in the case that the company decides to distribute the excess cash as a form of dividend (Filbeck, Zhao & Knoll, 2017). Relevant stakeholders could interrogate discrete information to measure the firms’ performance which could be identified through the effectiveness of particular activities or processes of production. Nonetheless, the conflict of interest involving shareholder and management could result in non-optimal decisions particularly in a business environment featured by lacking asymmetric information and incurrence of scrutinizing cost.

**Keynesian Liquidity Preference Theory**

Liquidity issue is one of the central targets to grapple with particularly in the condition of restrained financial resources accessibility in a firm. Keynesian liquidity preference theory (1936) has designated three purposes of holding cash which embracing transaction motive (use cash to maintain day-to-day business operations to ensure uninterrupted production schedule); precautionary motive (use cash to cushion for adverse market movements), and speculative motive. In the situation whereby several positive net present value (NPV) investment projects have been identified, financially constrained firms are compelled to shove aside costly opportunity costs by reducing heightened of transaction costs whilst liquidating convertible assets, in the intervening time delving for alternative sources of capital (Dittmar, Mahrt-Smith & Servaes, 2003). Under liquidity theory, trade credit reckons as an essential source of financing for smaller firms whereby the postulation stating larger firms which have greater opportunities to obtain funding from the capital market (Bellouma, 2014; Petersen & Rajan, 1997) could opt to provide interest-free financing for financially constrained firms.

**Free Cash Flow Theory**

Conforming to free cash flow theory, Jensen (1986) further explicates that managers propound to retain a certain level of cash in order to reinforce their control on the assets composition. The linkage of free cash flow with misappropriation of surplus funds has been implied as managers are more likely to invest in projects in which would ameliorate personal remuneration and power (Jensen, 1986), in case if they manage to use ‘cost-free’ financial resources to finance firm’s expansion projects. On top of the expansion in firm’s size, it turns out that managers may possibly go to withhold more resources under their control (Palombini & Nakamura, 2012; Zainudin et al., 2017a). On the other hand, a larger firm has predisposition to maintain a lower level of cash, laying forward the proviso of well-built affiliated relationship with financial institutions conjointly strong investor protection countries (Ferreira & Vilela, 2004; Zainudin et al., 2017b). The appositeness of maintaining an optimal working capital management would significantly affect the cash flow as implied through the length of cash conversion cycle whereby shorter CCC inclines to improve firm performance as lengthy CCC will lead to the need of external source of funding (Alshattarat, Nobance, Haddad & AlHajjar, 2010)

**Price Discrimination Theory**

Trade credit has been identified as an effective instrument for price discrimination as by offering credit could constructively reduce the price of the products. In keeping with the theory, the setting of credit terms is virtually adhered to conventional industry practices (Smith, 1980), whereby unvarying to the creditworthiness of the buyer which implying a lower cost of financing for poor payers meanwhile over-pricing for good payers (Petersen & Rajan, 1997). The theory reasons the abridgement of price discrimination with the exposition of instead prioritised the short-term sale which is characterised as more elastic, the firm posits for long-term consideration of client’s firm on-going operations which not only inclusive of existing sales but also the present value of its future sales. On the other perspective, offering credit to the customers might as well having
positive effects on firms sales revenue through allowing for price discrimination in between good payer and doubtful payer, serve a warranty for product quality, and build a long-term relationship with customers (Summers & Wilson, 2002).

Transactions Costs Theories
Ferris (1981) has elucidated that trade credit might play its role in diminishing transaction costs incurred when making payment to the suppliers. With the justification that the buyers could manage its cash more effectively when set apart the payment cycle from freight schedule, specifically for the seasonal businesses that tend to pile up inventories prior to peak season which triggered the upsurge of inventory holding cost (i.e. warehousing fees and financing costs). Firms could alleviate the variability of demand by offering discounts for early settlement and bulk purchases for buyers that possess the adequate capability of inventory storage (Petersen and Rajan, 1997).

From the perspective of cost advantages to offer trade credit, there are two essential points why suppliers (i.e. firms) have better standing as compared to conventional financial institutions (i.e. banks). Petersen and Rajan (1997) retaliate that suppliers are capable to acquire more useful information (for instance, number of orders, size of orders, a decision of undertaking early settlement discounts, the track record of previous payments) about buyer’s creditworthiness status as compared to bank (Schwartz, 1994). Next, the firms are presupposed in more secured position against the default risk correspond to banks due to the rationale suppliers could opt to terminate the supply of goods or seizing and liquidate the goods in case there is any occurrence of non-repayment (Bellouma, 2014).

3. Working Capital Management (WCM)
Working capital management has been exemplified as a routine function which is connected with management decisions which influence the level as well as effectiveness of the utilization of resources (Kaur, 2010) in order to finance the recurring revenue-generating business activities (Bhatia & Srivastava, 2016). Wanggu (2015) has affirmed that WCM as one of the principal pillars that substantially influences the pursuit of strategic financial goal whereas prioritizing in cost-effectiveness while organizing as well preserving short-term resources in order to assure the adequate capacity of firms to fulfil short-term obligations (Losbichler & Mahmoodi, 2012). Efficiency of working capital management links to release cash tied up from inventories and accounts receivable whereas pertaining to the antecedent of accelerating the collection of receivables in the shortest duration as possible on top of delaying disbursements to suppliers in the feasible yet lengthiest period (Nobanee, Abdullatif & AlHajjar, 2011). The optimal utilization of working capital surplus enables firms to maintain higher level of free cash flow whereas the cash holding pattern of a corporate could be illuminated through trade-off theory, pecking order theory, and free cash flow theory (Ganesan, 2007).

WCM ensures smooth operations of a firm by recognizing its effect on the liquidity and profitability level of the firm (Haron & Nomran, 2016). Working capital is contemplated as a measurement of operating liquidity (Singhania & Mehta, 2017) in which inefficient working capital management possibly will hinder the competitiveness advantages whereas give rise to the controversies such as overcapitalization i.e. disproportionate of working capital will result in extensive investment in fixed assets and overtrading i.e. exaggerated sales volume lead to incommensurate non-current assets in supporting the business operations. The disparity of the effectiveness in working capital investment is greatly relying on the strength of financial capabilities (Banos-Caballero, Garcia-Teruel & Martinez-Solano, 2014), whereby the argument is supported by the stronger the firm in their financial strength, the more likely it is going to have higher level of net working capital due to factors such as the
availability of retained earnings, greater accessibility to financial market and cheaper cost of financing (Fazzari & Petersen, 1993).

Components of Working Capital Management (WCM)

Inventory
Inventory is delineated as the accessibility of resources such as the supply of components, consumables, spare parts, sales items, obsolescent items, and all other supplies that maintain for the purpose of impending production and well along for sales, and possessing economic value in fulfilling the forecasted level of demand (Vrat, 2014). The disparity composition of assets particularly inventories has significant influence on firms’ WCM efficiency, as it has direct impact towards the trade-off of firms’ profitability and liquidity (Raheman & Nasr, 2007). Ostensibly, it’s prominence for firms to meritoriously invest in short-term assets (i.e. inventories and receivables) as it is the dynamism that driving the firm’s sales growth, as the argument of Moss and Stine (1993) stating that divergently, investment in non-current assets could be attenuating throughout the time horizon as corporations have alternatives of renting or leasing the assets. A shorter CCC implies higher opportunity cost whereby consists of the escalating risk of deterioration firm’s profitability due to shortage of inventories which might cause an upsurge of ordering as well as purchasing cost of inventories; losing sales as dispossesion of good creditworthiness customers through imposition of stricter trade credit policy; and retrograde firm’s reputation as deferring payments to suppliers. On the other hand, a longer CCC period is associated with higher carrying cost of inventories, plus intensification of short-term investment requirements as more financial resources are tied up with the current assets. Hence, trading-off between carrying costs and opportunity costs occurring in pursuit of effective inventory management (Nobanee & Al-Hajjar, 2011). Days of inventory outstanding (DIO) is one of the most relevant indicators used by firms to formulate inventory policies (Deloof, 2003; Raheman & Nasr, 2007). Providing the rationale that DSO are predominantly being used to offset the DPO, Motliček and Polák (2015) expound that inventory is the one of the WC components that affect the length of CCC at the greatest extent as strategic decisions that made on the purchases, production as well as the storage has impact on the time and financial constraints and consequently affect the firms’ profitability.

The preceding empirical researches have predominantly established the negative results of DIO towards firms’ performance (Lyngstadaas & Berg, 2016; Bhatia & Srivastava, 2016; Mansoori & Muhammad, 2012; Raheman et al., 2007; Zariyawati et al., 2009). An aggressive strategy of WCM will result in the reductions in inventory holding (Banos-Caballero et al, 2014) that resultant in the improvement of firm’s performance remarkably on the accounting measurements (e.g. ROA, ROE, ROIC) due to the rationale of minimization of inventory-holding costs which comprising of warehouse storage costs, insurance premium expenses, cost of spoilage and theft of inventory (Deloof, 2003). Contrastively, there are studies which demonstrate positive relationship between DIO and firm profitability (Makori & Jagongo, 2013; Mathuva, 2010), by means of higher levels of inventories are presumed to increment in sales and reducing transaction costs simultaneously (i.e. bulk purchase discount, reduce ordering costs, minimizing loss of sales etc.). Meanwhile, Yunos eta al. (2015) has attested 58 Malaysian listed non-financial government-linked corporation (GLCs) in the interval period of 2003-2014, has obtained non-significant results for DIO (Gill et. al. 2010). The inconclusive ramification on the significance of DIO towards firm’s performance has stimulate the researcher to delve further specifically for corporations deriving from diverse industries.
Accounts Receivable
The management of accounts receivable is essential to achieve an optimal balance in between the cash flow management components (Gill et al, 2010) in which it has a direct impact on a firm’s profitability (Lyngstadaas & Berg, 2016). The profitability of a firm could be increased by shortening the average collection period. The earlier studies conducted by the researchers like Deloof (2003), Lazaridis and Tryfonidis (2006), Gill et al (2010), Garcia-Teruel and Martinez-Solano (2007), and Mathuva (2010), has unveiled significant negative correlation between firms’ profitability and number of days to collect accounts receivable. Hence, the findings indicated that finance managers could play their roles in maximizing shareholders’ wealth by reducing the number of day’s accounts receivable to an optimum level.
### Table 2: Summary of previous researches

<table>
<thead>
<tr>
<th>Author (year)</th>
<th>No. of firms &amp; Duration</th>
<th>Dependent Variables</th>
<th>Independent Variables (results)</th>
<th>Control variables (results)</th>
<th>Methodology</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mathuva (2010)</td>
<td>30 listed firms / 1993-2008</td>
<td>NOP</td>
<td>DIO (+ve); DSO(-ve); DPO(+ve); CCC (-ve)</td>
<td>Firm size (+ve); Leverage (-ve); GDP growth rate (not sig); Fixed financial assets (+ve); Firm age (+ve)</td>
<td>Pooled OLS &amp; FEM</td>
</tr>
<tr>
<td>Raheman, Afza, Qayyum &amp; Bodla (2010)</td>
<td>204 Pakistani manufacturing, listed firms &amp; 1998-2007</td>
<td>Net operating profitability (NOP)</td>
<td>DIO (-ve), DSO (-ve), DPO (+ve); CCC (-ve)</td>
<td>GWCTR (+ve); CAR (+ve); CLR (-ve); LEV (-ve); Firm Size (+ve); Sales growth (+ve); Current ratio (no sig)</td>
<td>FEM</td>
</tr>
<tr>
<td>Mansoori &amp; Muhammad (2012)</td>
<td>92 Singaporean listed firms / 2004-2011</td>
<td>ROA</td>
<td>DIO (-ve), DSO (-ve), DPO (-ve); CCC (-ve)</td>
<td>Firm size (+ve); sales growth (+ve); leverage (-ve); GDP growth rate (+ve)</td>
<td>Pooled OLS</td>
</tr>
<tr>
<td>Makori &amp; Jagongo (2013)</td>
<td>10 Kenya listed firms from manufacturing &amp; construction industries / 2003-2012</td>
<td>ROA</td>
<td>DIO (+ve), DSO (-ve), DPO (+ve); CCC (-ve)</td>
<td>Sales growth (+ve), firm size (+ve), Leverage (-ve), Current ratio (+ve),</td>
<td>OLS</td>
</tr>
<tr>
<td>Yunos et al., (2015)</td>
<td>58 Malaysian listed non-financial GLCs / 2003-2014</td>
<td>GOI &amp; ROA</td>
<td>DSO(not sig); DIO(not sig); DPO(+ve) &amp; CCC(not sig)</td>
<td>Firm size (+ve); Sales growth (+ve); Leverage (-ve).</td>
<td>Panel Data Regression (pooled OLS, REM &amp; FEM)</td>
</tr>
<tr>
<td>Afrifa &amp; Padachi (2016)</td>
<td>160 UK AIM listed SMEs &amp; 2005-2010</td>
<td>ROA, ROCE &amp; ROE</td>
<td>CCC (-ve)</td>
<td>Firm age (+ve); Firm size (-ve); asset tangibility (-ve); Leverage (-ve); liquidity ratio (-ve); short-term financing (-ve); Industry</td>
<td>FEM</td>
</tr>
<tr>
<td>Bhatia &amp; Srivastava (2016)</td>
<td>179 Indian listed firms &amp; 2000-2014</td>
<td>Gross Operating Income (GOI); Tobin’s Q</td>
<td>DIO (-ve), DSO (-ve), DPO (-ve); CCC (-ve)</td>
<td>Firm size (+ve); Sales growth (no sig); Leverage (-ve); Fixed financial assets (+ve); variability in NOI (+ve); GDP growth rate (+ve)</td>
<td>OLS, FEM, REM &amp; GMM</td>
</tr>
<tr>
<td>Lyngstadaas &amp; Berg (2016)</td>
<td>21,075 Norwegian SMEs &amp; 2010 – 2013.</td>
<td>ROA &amp; ROIC</td>
<td>DIO (-ve), DSO (-ve), DPO (-ve); CCC (-ve).</td>
<td>Firm size (+ve); Sales growth (+ve); Leverage (-ve); CAR (+ve); CLR (+ve), GDP Growth (+ve)</td>
<td>FEM</td>
</tr>
<tr>
<td>Jakpar et al. (2017)</td>
<td>164 Malaysian listed manufacturing firms / 2007-2011</td>
<td>ROA</td>
<td>LCCC (-ve, not sig); LACP (+ve); LICP (+ve); Leverage (-ve); Firm size (+ve).</td>
<td>Nil</td>
<td>Panel Data Regression (pooled OLS, REM &amp; FEM)</td>
</tr>
</tbody>
</table>
The theory that embedded to explain the state of trade credit offering is associated to trade-off theory. The generous credit policy may escalate the trading volumes, nonetheless increase the likelihood of bad debts occurrence whereby deteriorating the profitability. Conversely, a stringent policy could reduce cost of capital invested in receivables management, with the adverse impact towards the firm’s sales and profitability. Petersen and Rajan (1997) explicates three main theories that being adopted to explain the incentives for businesses to extend trade credit which encompasses financial advantage theory (profit maximization), price discrimination theory (market power), and transaction cost theory (cost advantage).

Accounts Payable
Trade credit plays a substantial role to finance business short term operational liabilities (Petersen & Rajan, 1997) in which it allows the firms to enjoy interest-free source of capital meanwhile able to invest their surplus cash in between of time period to earn excess short-term return (Tauringana & Afrifa, 2013). Madishetti and Kibona (2013) signifies that a proper planned and executed payable management is probable to contribute positively to the expansion of firms’ activities, consequently boosting sales revenue which enabling the firms to ameliorate the regeneration of funds and further generating higher level of profitability. During the tightening monetary supply periods, Atanasova (2008) study reveals that cash constrained firms tend to substitute trade credit to institutional financing as it diminishes the purchasing costs, by means of having adequate time duration to ascertain the quality of products before making the payment to the suppliers (Petersen & Rajan, 1997).

Cash Conversion Cycle (CCC)
Cash conversion cycle (CCC) which is delineated as a combined measurement illustrating the average period of time between the payment of raw materials procurement to the suppliers, subsequently work-in-progress processes, and ultimately collection of receivables from the credit customers (Al-Shubiri & Aburumman, 2013; Makhsun et al., 2018). CCC is introduced by Gitman (1974) and is treated as vigorous measure since it is able to capture the non-synchronization of short-term cash inflows and outflows (Wasiuzzaman, 2015) as well as containing information arisen from both balance sheet and income statement (Aytaç, Hoang, Lahiani & Michel, 2016). The conception of WCM and the cash conversion cycle (CCC) have been examined from different perspectives. As a summary of the preceding empirical researches, it could be categorizes into four aspects as follows: (i) those results showing positive relationship (Gill et al., 2010; Sharma & Kumar, 2011; Abuzayed, 2012) or negative relationship (Jose, Lancaster & Stevans, 1996; Deloof, 2003; Garcia-Teruel & Martinez-Salano, 2007; Mathuva, 2010; Jones Osasuyi and Mwikipsile, 2017, Le et.al. 2018; Ali and Anis, 2018; Hakim and Kasenda, 2018; Musah, 2018) between the two variable despite of various dependent variables are used such as return on assets (ROA), return on invested capital (ROIC) and gross-and net operating income would take into account methodological issues; (ii) controlling for endogeneity; (iii) exploring non-linear relationship; or (Hamzah) investigate the optimal level of WCM (Lyngstadaas & Berg, 2016).

4. Conclusion
The preceding empirical findings has affirmed that the working capital as one of the most influential yet least comprehend drivers for supply chain managers (Losbichler & Mahmoodi, 2012) in order to improve a firm’s cash flow and profitability (Deloof, 2003; Danbaba, et.al. 2016; Malimi, 2017; Khan & Ali, 2017; Mazarø, 2018; Mokgari & Pwaka, 2018). Nevertheless, the precedent literature has enlightening that the corporate finance have conventionally put greater emphasize on long-term financial decisions such as investments, capital structure, dividends and corporate valuations decisions (Almeida & Eid Jr, 2014) as evidenced major theoretical
developments have occurred in the areas of long-term investment and financial decision-making. Hence, this paper has been elucidating the development of theoretical model which used to explain the practicality of models applying in explaining the influence of working capital components i.e. inventories, receivables and payables towards firms performance.

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