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Analyzing the Relationship between Corporate Governance and Working Capital Management in Malaysian Manufacturing Public Listed Companies: A Conceptual Study

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Abstract

In recent years, Malaysian businesses have faced various issues related to working capital management (WCM), which have affected their profitability, liquidity, and overall financial performance. According to a report by the World Bank, only 18.5% of Malaysian SMEs (which include many manufacturing companies) had access to formal financing in 2018, with the majority relying on internal funds or informal sources of financing (World Bank, 2020). This lack of access to financing can lead to cash flow problems and hinder companies' ability to manage their working capital effectively. This conceptual paper aims to investigate the impact of corporate governance on WCM in Malaysia's manufacturing public listed companies. The manufacturing sector is a significant contributor to Malaysia's economy, accounting for over 23% of the country's Gross Domestic Product (GDP) and providing employment to over 2 million people (Department of Statistics Malaysia, 2021). The study employed a qualitative approach, which involved a thorough review of relevant literature on corporate governance and WCM. At the end of this discussion, this study will show the links and correlations between Corporate Governance and WCM. In conclusion, this study found that CEO duality, board size, and audit committee are elements that influence WCM. These findings provide valuable insights for policymakers, management, and investors in enhancing corporate governance practices and WCM.

Keywords: Corporate Governance, CEO Duality, Board Size, Audit Committee, Working Capital Management (WCM).

Introduction

According to Azim (2012), the impact of corporate governance on WCM has been a subject of interest for researchers and practitioners alike. Effective corporate governance is crucial for the success of any organization, including public listed companies. The board of directors plays a vital role in ensuring that companies operate efficiently and effectively. In recent years, there has been an increasing interest in the impact of corporate governance on WCM. The COVID-19 pandemic has posed significant challenges for Malaysian manufacturing companies' WCM. According to a survey by the Federation of Malaysian Manufacturers, 45% of respondents reported cash flow as a major challenge during the pandemic (Federation of Malaysian Manufacturers, 2020). The pandemic has disrupted global supply chains and led to increased uncertainty, which can affect companies' ability to manage their working capital effectively. WCM is an essential component of a company's financial management, and it involves managing the cash conversion cycle (CCC) and maintaining an appropriate level of current assets to meet short-term obligations.

Several studies have examined the relationship between corporate governance and WCM, and most of these studies have been conducted in developed countries. However, little research has been conducted in emerging markets, particularly in Malaysia. Therefore, this study aims to investigate the impact of corporate governance (represented by CEO duality, board size, and audit committee) on WCM in Malaysia's manufacturing public listed companies.

Background of the Research

Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled, while WCM involves the management of a company's short-term assets and liabilities (Gupta & Jain, 2013). Good corporate governance is important for maintaining the integrity of a company and for protecting the interests of all stakeholders.

WCM, on the other hand, refers to the management of a company's short-term assets and liabilities. It involves managing the company's cash, accounts receivable, inventory, and accounts payable. Effective WCM is important for ensuring that a company has sufficient cash flow to meet its short-term obligations and to fund its operations.

The research paper focuses on Malaysian manufacturing public listed companies because of several factors. Firstly, these companies are required to comply with strict corporate governance regulations under the Malaysian Code on Corporate Governance. Secondly, the study is also important because WCM is critical for manufacturing companies, which typically have significant investments in current assets. According to Chong and Choong (2012), manufacturing companies typically have significant investments in inventory and receivables, which makes effective WCM critical for their financial performance. Lastly, previous research has suggested that WCM practices in Malaysian companies are not optimal, and there is room for improvement (Lau et al., 2012). Therefore, further research is needed to identify and address the factors that contribute to poor WCM practices in Malaysian manufacturing companies.

The study is significant as it provides insights into how good corporate governance practices can be used to ensure effective WCM in Malaysian manufacturing public listed companies, which are subject to strict corporate governance regulations under the Malaysian Code on Corporate Governance.

Problem Statement

Corporate governance plays a crucial role in ensuring transparency, accountability, and effective decision-making within organizations (Kardos, 2012). Investigating the relationship between corporate governance and WCM is essential to understand how governance practices can impact the financial management of companies in Malaysia.

WCM directly affects the financial health and profitability of companies. Examining how corporate governance practices influence WCM can provide valuable insights into strategies for optimizing working capital and improving financial performance in the Malaysian manufacturing sector (Gorondutse et al., 2017).

The manufacturing sector holds great significance in the Malaysian economy. Understanding the relationship between corporate governance and WCM in this sector is important for identifying best practices and areas of improvement to enhance financial performance and sustainability for manufacturing companies (Alodat et al., 2022).

Additionally, effective corporate governance practices and efficient WCM are crucial factors that attract investors and enhance stakeholder confidence. Understanding the relationship between these two areas can shed light on how companies can strengthen their governance practices and optimize working capital to create value for investors and stakeholders (Rahman et al., 2019).

Considering the scarcity of studies on this topic, particularly within the context of Malaysia, it is crucial to conduct extensive research to provide sufficient evidence and contribute to the existing literature.

Research Gap

While previous research has explored the impact of corporate governance on various financial aspects such as firm performance and financial reporting quality, there is a noticeable research gap regarding the specific influence of corporate governance on WCM in the context of Malaysian manufacturing public listed companies. Existing studies in Malaysia have primarily focused on the relationship between WCM and firm performance, overlooking the crucial role of corporate governance as a determinant of efficient WCM (Chaudry & Ahmad, 2015). In addition, most studies in Malaysia have concentrated on the relationship between WCM and firm performance, neglecting the perspective of corporate governance.

Furthermore, corporate finance literature has traditionally emphasized long-term financial decisions rather than the short-term aspects Kasiran et.al (2016) represented by WCM. This literature gap highlights the need for further investigation into the relationship between corporate governance and WCM efficiency, particularly in terms of liquidity measures such as the conversion cycle and current ratio.

Given the limited evidence and inconclusive findings from previous studies, it is crucial to conduct an in-depth research study to fill this research gap. Exploring the impact of corporate governance mechanisms on WCM in Malaysian manufacturing public listed companies can provide valuable insights for practitioners, regulators, and policymakers in enhancing corporate governance practices and optimizing WCM efficiency.

Literature Review

Corporate governance is the system of rules, practices, and processes by which a company is directed and controlled. The board of directors is responsible for setting the company's strategic direction and ensuring that it is managed effectively. Corporate governance plays a vital role in managing working capital by monitoring and managing the company's financial affairs.

WCM is a crucial aspect of financial management that focuses on managing a company's short-term assets and liabilities to ensure smooth operations and financial stability. It involves effectively managing inventory, accounts receivable, accounts payable, and cash conversion cycles. In recent years, researchers have recognized the significant influence of corporate governance practices on WCM efficiency.

Chaudhry and Ahmad (2015) highlight the significant influence of corporate governance practices on WCM. They suggest that proper implementation of corporate governance practices can improve WCM efficiency. Additionally, Achchuthan and Kajananthan (2013) propose that efficient WCM policies must be developed and implemented through effective corporate governance practices. Ahmad et al (2018) find that corporate governance mechanisms have a significant impact on WCM.

Therefore, this study aims to examine the impact of corporate governance, represented by CEO duality, board size, and audit committee, on WCM in Malaysian manufacturing public listed companies.

CEO Duality

The relationship between CEO duality, which refers to the situation where an individual serves as both the CEO and the chairman of the board within an organization, and WCM has been a topic of considerable interest in the corporate governance literature. Several studies have explored the potential impact of CEO duality on WCM practices and their implications for firm performance.

Some researchers argue that CEO duality can have a negative effect on WCM. For instance, Kumpamool and Chancharat (2020) found that CEO duality has a negative effect on aggressive policies in working capital investment. The concentration of power in a dual CEO-chairman role may lead to managerial entrenchment, which can result in suboptimal WCM decisions.

CEO duality refers to the situation where an individual holds both the CEO and chairman positions in a company. This study's findings indicate that CEO duality has a significant negative impact on WCM, as companies with CEO duality tend to have a lower current ratio and a longer cash conversion cycle. This finding supports a previous study Rutledge et al., (2016) that found CEO duality to have a negative impact on financial performance.

In contrast, other studies suggest that CEO duality can actually have a positive effect on WCM. For example, Gill et al (2023) found a significant positive relationship between CEO duality and WCM efficiency in Indian firms. They argue that the combined roles of CEO and chairman can lead to more effective coordination and decision-making, resulting in improved WCM practices.

Additionally, some researchers have examined the moderating role of firm characteristics on the relationship between CEO duality and WCM. Li et al (2014) found that the impact of CEO duality on WCM efficiency is contingent on firm size. They found a positive relationship between CEO duality and WCM efficiency in smaller firms, but a negative relationship in larger firms. They suggest that the size of the firm may influence the ability of a dual CEO-chairman to effectively manage working capital.

In summary, the literature on the relationship between CEO duality and WCM presents mixed findings. While some studies suggest a negative impact of CEO duality on WCM efficiency, others propose a positive association. Moreover, the moderating role of firm characteristics, such as firm size, adds complexity to the relationship. Further empirical research is needed to better understand the mechanisms and contingencies underlying the relationship between CEO duality and WCM.
Therefore, this study proposes the negative relationship between CEO duality and WCM which results in potential conflict of interest. When a CEO holds both positions, there may be a concentration of power, which could lead to decisions that prioritize the CEO's interests over the efficient management of working capital. This could result in suboptimal WCM practices, such as excessive inventory holdings, lack of accounts receivable and accounts payable management, or inefficient cash flow management.

Board Size
The relationship between board size, which refers to the number of directors serving on a company's board, and WCM has been a topic of interest in corporate governance and financial management literature. Researchers have examined whether board size influences the efficiency and effectiveness of WCM practices within organizations.

Some studies suggest that board size has a significant impact on WCM. For instance, Goel et al., (2015) found negative relationship on WCM in Indian manufacturing sector. They found that an bigger board size weakens control and influences the management to take aggressive WCM strategies which results in higher risk to the firm.

Furthermore, researchers have also explored the moderating role of board independence in the relationship between board size and WCM. Dang et al (2019) investigated Vietnamese firms and found that the negative impact of board size on WCM efficiency is mitigated by higher levels of board independence. They argue that independent directors bring diverse expertise and perspectives, which can help overcome the potential challenges associated with larger boards.

In contrast, other studies have found mixed or inconclusive results regarding the relationship between board size and WCM. For example, Saeed et al (2018) conducted a study on Pakistani firms and found no significant association between board size and WCM efficiency. They suggest that the relationship may be influenced by various contextual factors, such as firm size and industry characteristics.

In summary, the literature on the relationship between board size and WCM presents mixed findings. While some studies indicate a negative relationship between board size and WCM efficiency, others suggest no significant association or identify moderating factors, such as board independence. The varying results highlight the importance of considering contextual factors and the composition of the board in understanding the impact of board size on WCM.

Therefore, this study proposes the negative relationship between board size and WCM which results in decision making inefficiency. A larger board size may result in decision-making inefficiencies and difficulties in reaching timely and consensus-based decisions. With more members on the board, there can be increased coordination challenges, communication complexities, and a higher likelihood of conflicting viewpoints. This can hinder the efficient management of working capital, as decisions related to inventory management, accounts receivable, accounts payable, and cash flow may be delayed or subject to prolonged discussions. As a result, working capital may not be managed optimally, leading to potential inefficiencies and negative impacts on the company's financial performance.

Audit Committee

The relationship between the Audit Committee and WCM has gained significant attention in corporate governance and financial management literature. The audit committee, as a key component of corporate governance mechanisms, plays a critical role in overseeing financial reporting and internal control systems within organizations. Researchers have explored the impact of the Audit Committee on WCM practices and their implications for firm performance.

Several studies suggest that an effective Audit Committee positively influences WCM practices. For instance, Chen et al (2013) found a significant positive relationship between the strength of the Audit Committee and WCM efficiency in Chinese listed firms. They argue that an active and independent Audit Committee promotes greater financial transparency and control, leading to improved WCM decisions. This finding supports a previous study (Leung and Cooper, 2010) that suggests that audit committees play a critical role in monitoring and managing a company's financial affairs.

Furthermore, research has shown that the characteristics of the Audit Committee, such as independence and financial expertise, are crucial factors influencing WCM. Ahmad et al (2018) found that the presence of financially knowledgeable and independent members on the Audit Committee is associated with enhanced WCM efficiency in Malaysian firms. They suggest that the expertise and objectivity of Audit Committee members contribute to better monitoring and decision-making related to WCM.

Moreover, some studies have examined the mediating role of the Audit Committee in the relationship between other corporate governance mechanisms and WCM. For example, Agha

et al (2017) investigated Pakistani firms and found that the presence of a strong Audit Committee mediates the relationship between ownership structure and WCM efficiency. They propose that the Audit Committee acts as a monitoring mechanism that bridges the gap between ownership concentration and effective WCM.
In summary, the literature indicates a positive relationship between the Audit Committee and WCM practices. An effective and independent Audit Committee, along with financial expertise, contributes to improved WCM efficiency. Furthermore, the Audit Committee can mediate the relationship between other corporate governance mechanisms and WCM. These findings highlight the importance of a robust Audit Committee in promoting effective WCM practices within organizations.

Based on this study, it is proposed that there is a positive relationship between audit committee and WCM which results in enhancing governance and expertise. A larger board size can potentially bring diverse expertise and perspectives to the decision-making process. With more members on the board, there is a higher likelihood of having individuals with specialized knowledge in finance, operations, and supply chain management. This can result in a more comprehensive evaluation of WCM strategies, improved monitoring of inventory levels, accounts receivable, and accounts payable, and better cash flow management. A larger board may provide a broader range of skills and experiences, leading to enhanced governance practices that positively influence WCM efficiency.

The Propose Conceptual Framework
To understand the study, a conceptual framework is necessary. This study aims to focus potential for factors influencing impact WCM. Based on the literature review of this study, the conceptual framework is shown in Figure 1.

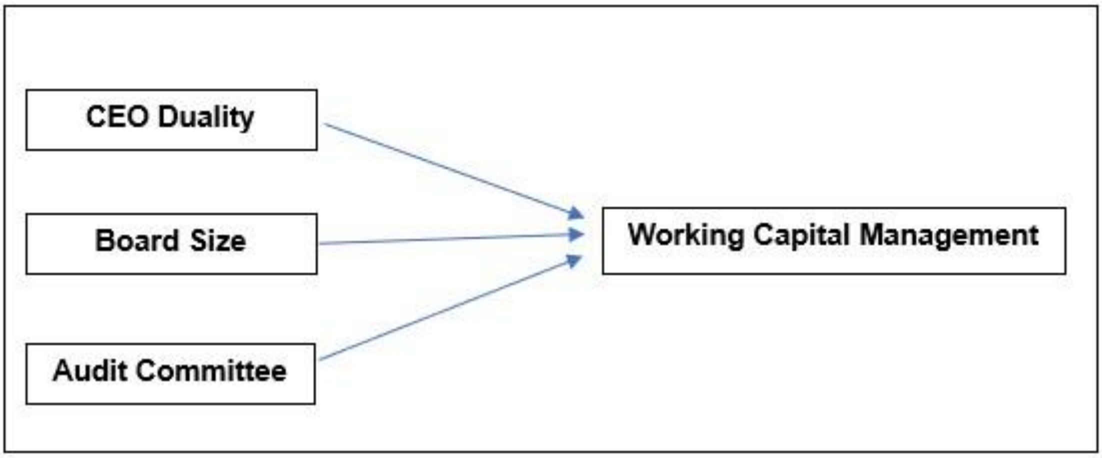

Figure 1: *Factor Influencing Impact of Corporate Governance on Working Capital Management.*

Figure 1 illustrates the factors that drive the impact of working capital management in the organization. Based on figure 1, Corporate Governance represented by CEO duality, Board size and Audit committee are the factors that impact the intergroup and intragroup conflict to the organization.

Conclusion

This study provides evidence of the impact of corporate governance, represented by CEO duality, board size, and audit committee, on WCM in Malaysian manufacturing public listed companies. The findings of this study suggest that CEO duality and board size has a negative impact on WCM, while the presence of an audit committee has a positive impact.

This conceptual paper aimed to explore the relationship between CEO duality, board size, and audit committee with WCM in Malaysian manufacturing public listed companies. The findings of this conceptual paper suggest several important considerations. The presence of CEO duality, where the roles of CEO and board chairperson are combined, may lead to a concentration of power and limited checks and balances. This concentration of power could potentially hinder effective WCM practices, as decision-making authority may be consolidated, and oversight may be compromised. Therefore, it is crucial for companies to evaluate the potential risks associated with CEO duality and consider the benefits of separating these roles to enhance corporate governance and improve WCM.

Furthermore, the size of the board of directors can have implications for WCM. Larger boards may face challenges in achieving effective communication, decision-making, and coordination. This could lead to delays and inefficiencies in WCM processes. Companies should carefully consider the optimal board size that allows for diversity, expertise, and efficient decision-making to ensure effective WCM practices.

Additionally, the presence of an independent and competent audit committee is crucial for robust WCM. The audit committee plays a vital role in providing oversight, reviewing financial policies and practices, and ensuring compliance with regulations. By having a well-structured and proficient audit committee, companies can enhance financial transparency, internal controls, and overall WCM efficiency.

In conclusion, these findings have important implications for companies and their stakeholders, as they highlight the importance of effective corporate governance in managing working capital and ensuring a company's financial stability.

Recommendation

Considering the potential risks associated with CEO duality, it is recommended that companies seriously consider separating the roles of CEO and board chairperson. This separation can promote better checks and balances, enhance corporate governance, and ensure more effective decision-making.

Additionally, to improve WCM practices, companies should carefully evaluate their board size. It is recommended to strike a balance between having a sufficient number of directors to ensure diverse expertise and perspectives, and avoiding an excessively large board that may hinder effective communication and decision-making.

Moreover, given the crucial role of the audit committee in overseeing financial matters, including WCM, companies should focus on strengthening the composition and effectiveness of their audit committees. This includes appointing independent directors with relevant financial expertise and ensuring the committee has the necessary resources and authority to carry out its responsibilities effectively.

Finally, Empirical studies should be conducted using quantitative data to provide statistical evidence and further insights into these relationships. Future research can explore the impact of other corporate governance factors and contextual variables as well as the intermediating variables that might influence the relationship of corporate governance on WCM.

Overall, the proposed study can enhance our understanding of the relationship between corporate governance and working capital management in Malaysian manufacturing public listed companies, which can benefit both academic and practical knowledge. The results may contribute to improved corporate governance practices, better working capital management plans, and greater financial performance by offering practitioners, policymakers, and scholars in the sector with useful insights.

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