

Nexus between Working Capital Management and Financial Performance of Small Enterprises

Bature Samson Waibe*¹, Asmau Salihu¹, & Nwogu Jorji Akudo²

¹Department of Accounting Education, School of Business & Entrepreneurial Education, Federal College of Education (Technical), Gusau, Zamfara State

²Department of Economics Education, School of Business & Entrepreneurial Education, Federal College of Education (Technical), Gusau, Zamfara State

*Correspondence Email: samwebs2014@gmail.com

Abstract

This study investigates the impact of working capital management on the financial performance of small enterprises in Kano, Nigeria. A cross-sectional survey of small enterprises owners or managers in Kano was conducted through self-administered questionnaire. Variance-base structural equation modelling statistical technique called partial least square (PLS) version 4.0.9.5 was utilized to examine the relationship between working capital management and financial performance. The findings of the study indicate that working capital management has a statistically significant positive impact on financial performance of small enterprises. Specifically, the results show that small enterprises with higher working capital management have better financial performance in terms of sales growth, profitability, liquidity, solvency, and return on assets. The study offers useful recommendations to small business operators and suggests interesting direction for future research.

Keywords: Funds, liquidity, short-term, small enterprises, cash flows

JEL Classification: L25, P17

1. Introduction

Micro, small, and medium enterprises (MSMEs) play a strategic role in terms of growth and development in most economies around the world (Adeosun, & Shittu, 2022). MSMEs are widely known for immense contribution in the area of innovativeness, employment, creative thinking, and entrepreneurship development, local materials mobilization for the purpose of production, support big enterprises, creation of wealth, improvement in standard of living, and increment in GDP (Chatterjee & Kar, 2020; Papadopoulos et al., 2020). No wonder, Grohmann et al. (2018) state MSMEs are major players in socio-economic advancement of many economies around the world.

In support of the foregoing, Dabić et al. (2020), as well as Gopal and Schnabl (2022) posit that small and medium enterprises' constitution to job creation and

gross domestic product GDP is estimated at 60% and 40% respectively worldwide. Also, they went further to state that over 95% of business ventures across the globe are SMEs. In the same vein, within nations that constitute the European Union (EU), there are over 26 million small enterprises that generate approximately One Hundred and Nine million jobs 2/3 European Gross National Product (Erdirin & Ozkaya, 2020). This offers explanation as to why small enterprises are referred to as the mainstay of progress in most economies (Dabić et al., 2020).

Recognizing the importance of MSMEs in many nations across the world, particularly in emerging countries like Nigeria had initiated several policy frameworks such as National Directorate of Employment (NDE), MarketMoni/tradermoni, and so on directed toward supporting MSMEs. Despite the numerous efforts of successive governments over time to ensure MSMEs thrive to achieve their potentials, MSMEs contribute to building a viable economy seems abysmal. For example, evidence demonstrates MSMEs provide jobs to about 3 million people in Nigeria (National Bureau of Statistics, 2019).

Relating the job creation statistics of MSMEs as indicated in the preceding paragraph with estimated Nigeria's population which stood at 213.4 million (World Bank, 2021), reveals that only 1.4 per cent of the total population is engaged by MSMEs in Nigeria. The poor record performance can be seen in rising statistics of the unemployed and the less privilege in Nigeria. Records of the National Bureau of Statistics (2022a; 2022b) indicate that whereas 33.3% Nigerians are unemployed, 133 million Nigerians battle with multidimensional poverty. Assuming the potentials of MSMEs are brought to limelight in Nigeria, unemployment and poverty would not have been issues of national concern.

Existing studies demonstrate attribute abysmal performance of this sub-sector in Nigeria to several factors. For instance, inadequate access to finance (Effiom & Edet, 2018), poor financial management practice (Gumel, 2017; Agwu, 2018); inadequate accounting books and poor knowledge of record keeping (Ezeagba, 2017; Mpi, 2019). Despite several studies had enumerated a range of challenges and prospects of this sub-sector of the Nigeria's economy (e.g., Agwu, 2018; Effiom & Edet, 2018; Ezeagba, 2017; Gumel, 2017; Mpi, 2019), not much is known regarding the manner financial management practices impacted on MSMEs' financial performance.

Further indication in the literature shows that rarely would one come across empirical study on MSMEs as bulk of the studies in Nigeria are either conceptual in nature or merely a literature review. This means a scarcity of empirical evidence upon which inferences could be made. In another viewpoint, despite Gumel (2017) and Agwu (2018) suggested poor financial management practice as one of the militating factors against the growth of MSMEs in Nigeria, majority studies concentrated only on inadequate access to finance forgetting the premises upon which access to finance relied on (e.g., Oko-Oboh & Bukar, 2022; Effiom & Edet, 2018; Mpi, 2019). The expectation is that cash flows utilization challenges should be of more concern in business operation than inadequate access to finance. This argument may sound logical because if properly utilized, limited financial resources could turn an enterprise greater than having robust finance without good

financial management practice in place. Hence, a knowledge gap that deserve scholarly attention.

To this end, as an integral component of financial management practices, it may not be out of point to raise a fundamental question - does working capital management (WCM) impacted on small enterprises' financial performance? Providing appropriate answers to this question would go a long way to create understanding about the eminence of financial management practice in firms' survival, good performance, and growth. This would stimulate enterprise owners or managers to engage in the practice of good financial management. It may also assist policymakers in initiating broad base ideas targeted at resolving financial problems of enterprises (specifically, small enterprises) which may bring about their survival, good performance, and growth. This study would equally stimulate further research in the area of financial management practices as applicable to small businesses.

The sections that follow are theoretical background and hypothesis development, methods used in the study, results and discussion, as well as implications, and direction for further study.

2. Literature Review

Firms' performance

Fareed et al. (2016) view firms' performance as a crucial means for assessing the doggedness, success of enterprises over time. Several approaches may be adopted in evaluating firms' performance at any given time. In some instances, firms' performance is considered a multi-dimensional or unidimensional construct. When considered as a multi-dimensional construct, it is often classified as financial and non-financial dimensions (Saif et al., 2022). However, evaluation of firms' financial performance may be objectively conducted through firms' financial records or subjectively through the perceptions of business owners or managers (Rauch et al., (2009). The objective measurement of firms' financial performance include profitability, efficiency, market share, growth, leverage, and liquidity. Whereas the subjective indicators are employee satisfaction, shareholder satisfaction, customer satisfaction, service delivery, and overall enterprise performance. It is worthy of note that evaluation of firms' performance through objective measures could be done in relative terms contingent on data availability.

On the ground of preceding explanation, the current study defines firms' performance from the angle of financial performance of small businesses in Nigeria. Nonetheless, given the nature of small businesses in Nigeria (i.e., no annual financial report publication requirements), this study relied on perceptions of owners or managers of small businesses. Duréndez and Madrid-Guijarro (2018) supported this approach to measuring firms' financial performance. In addition, it was argued that in events where financial records are inaccessible, unbiased judgement of business owners or managers regarding their enterprises' performance could offer much needed insights of firms' performance (Dess & Robinson, 1984).

Micro, Small and Medium Enterprises

It is rare to identify research that exclusively examined small enterprises in Nigeria without including either micro or medium firms. Being a component of either SMEs or MSMEs, Effiom and Edet (2018) as well as Oko-Oboh and Bukar (2022) defined small businesses as any ventures with a staff strength between 10 and 49, and an asset base between 5 and 49 Million Naira, with exception of costs of land and building. Also, Effiom and Edet (2018), and Oko-Oboh and Bukar (2022) viewed micro enterprises as outfits with employees fewer than 10 and assets whose value is less than ₦5 Million. Whereas, medium enterprises referred to those establishments with employees numbered between 50 and 199 and assets valued between ₦5 Million, excepting land and building.

Going by various definitions in the preceding paragraph, this study argued that small enterprises are distinct from micro and medium businesses with respect to staff strength and value of assets. The distinction in definition is most probably going to lead to disparity in operational and procedural processes between these enterprises. As such for the sake of dependable research findings targeted toward addressing the challenges to allow for better performance of MSMEs in Nigeria, they should be treated separately in terms of research. In line with this thought, the current research examined small enterprises only.

Small businesses are often referred to ventures owned, maned, or controlled by a person or group of persons. Thus, the ownership form of business for small enterprises is either a sole proprietorship or partnership. This category of ventures require much human capital to operate effectively. Hence, they are labour intensive. These business owners scout for capital from varied sources such as personal savings, loan or gift from friends or family members, grant from government or NGO, loan from cooperative societies or financial institutions (Oko-Oboh & Bukar, 2022). In terms of goods and service delivery, small enterprises are involved in production, buying, and selling of a wide range of goods and services.

This category of establishments contribute immensely to growth and development of many economies across the globe. For example, Adeosun and Shittu (2022), Chatterjee and Kar (2020), Oko-Oboh and Bukar (2022), and Papadopoulos et al. (2020) affirmed that small enterprises mobilize local raw materials for the sake of productive activities, generate employment, encourage entrepreneurial activities (i.e., creative thinking, innovativeness, proactiveness, and risk taking), serve as suppliers to large enterprises, source of wealth creation, source of improved standards of living, and source of increment in GDP. No wonder, Grohmann et al. (2018), and Yemelyanov et al. (2020) state that small enterprises occupy pivot role when it comes to socio-economic progress of any economy across the globe. This provide answers to why Dabić et al. (2020), Erdin and Ozkaya (2020), as well as Gherghina et al. (2020) viewed small enterprises as the bedrock upon which growth and development of most economies are dependent.

Despite these enormous potentials, Oko-Oboh and Bukar (2022) observed that small enterprises' contribution for sustainable development in Nigeria is abysmal as a result of varied factors among which is poor financial management practice. For example, evidence demonstrates small businesses provide jobs to about 3 million

people in Nigeria (National Bureau of Statistics, 2019). Relating the job creation statistics of this category of business with estimated Nigeria's population which stood at 213.4 million (World Bank, 2021), reveals that only 1.4 per cent of the total population is engaged by small enterprises in Nigeria. The poor record performance can be seen in rising statistics of the unemployed and the less privilege in Nigeria. Records of the National Bureau of Statistics (2022a; 2022b) indicate that whereas 33.3% Nigerians are unemployed, 133 million Nigerians battle with multidimensional poverty. Assuming the potentials of MSMEs are brought to limelight in Nigeria, unemployment and poverty would not have been issues of national concern.

Financial Management Practices

The success or failure of business ventures is largely predicated upon the extent to which financial management practice is embraced. In the view of Shim and Siegel. (2007), financial management as a sub-set of economics which is concerned with addressing financial issues related to sources and uses of funds in enterprises. Maintaining sound financial management practice in business aids good decision making with respect to funds procurement, distribution and use. Put differently, financial management guides enterprises to get the best from funds application with aims of achieving profit goals and maximizing wealth of stakeholders. Financial management entails enterprise's systematic planning that guarantees steady flow of funds and prudent utilization (Tony-Obiosa & Ibama, 2021). In summary, financial management evaluates activities of the firm in relation to financial planning, controlling, and investment appraisal. Thus, the ultimate focus of financial management is procurement of funds, distribution of same among competing needs or units, and prudent utilization to permit attainment of business objectives.

The components of financial management practice in business as specified in Shim and Siegel (2007) are financial planning, budgeting and forecasting, identification of sources of funds, analysis of cost of borrowing, procurement and utilization of funds, records of cash flows, assessment of financial statements, evaluation of working capital management, time value of money analysis, determination of dividend policy, risk management assessment, as well as merger and acquisition. Unlike large enterprises, small businesses are not mandated by law to make public their financial statements. However, Oko-Oboh and Bukar (2022) identified some accounting ratio owners or managers of small enterprises might adopt in determining their success or failure. In this regard, Oko-Oboh and Bukar (2022) posit the accounting ratios may be classified into traditional and functional ratios. While the traditional ratios include profit and loss accounting ratio, balance sheet ratio, and composite ratio, the functional ratios are solvency ratio, liquidity ratio, activity or turnover ratio, and profitability ratio.

But then when it comes to decision making in organization, financial management practice span through broad activities to include capital budgeting, capital structuring, working capital management, dividend policy (Folajinmi & Peter, 2020). In this study, attention was given to working capital management only due to its role of providing liquidity to the enterprise.

Working Capital Management (WCM)

Ajayi et al. (2017) posit that working capital may be described using two approaches which include gross and net approaches. On one hand, the gross approach to description of working capital refers to overall assets which a firm may convert with maximum ease into cash within a year. It represents a firm's proportion of assets held in a form that can be used to address short-term financial needs. On the other hand, net approach to explanation of working capital describes the situation whereby long-term funding options are utilized to finance current assets of a firm.

Tony-Obiosa and Ibama (2021) describe working capital management as efficient and effective maintenance of short-term assets and short-term liabilities of business ventures such that adequate cash flows is guaranteed at all times for smooth operations. Similarly, WCM is concerned with maintaining prime liquidity level which may only be achieved through close monitoring and controlling elements of current assets and current liabilities such as inventory, account receivable, cash, account payable, marketable security (Hossin & Begum, 2020; Ojeani, 2014).

Inventory management describes analysis of costs-benefits of holding inventory (Kontuš, 2014). Business ventures experience reduction in costs of inventory and increase in profit when inventory is efficiently managed. Therefore, maintaining just an ideal quantum of inventory by enterprises is essential for smooth operation and success of business ventures. Regarding management of cash, it emphasizes the significance of keeping just enough cash at hand to address day-to-day financial needs. Apart from the forgoing, cash management is put in place to avoid keeping idle cash or witnessing cash shortage in an enterprise. Keeping idle cash is not wise as it could be invested and in turn yield some returns. Also, a cash shortage would have negative effect on the organization as it may lack the capacity to meet daily financial needs. Account receivables management means maintaining the best credit policy. The best credit policy refers that optimum credit level which exploits maximum return from credit sales. Lastly, any venture's effort to put a close watch on level of trade credit and short-term borrowing is regarded as management of account payables.

The preceding paragraph underscores the significance of WCM as a component of financial management practice in ensuring that enterprises maintain appreciable level of liquidity at all times for uninterrupted conduct of business operation. Thus, sound WCM is crucial in pursuit of business goals and/or objectives. This explains the reason for considering WCM only in this study.

Working Capital Management (WCM) and Firm Performance

Existing studies have exhibited associations between WCM and firms' performance. For instance, Prempeh and Peprah-Amankona (2019) investigate the relationship between WCM and firms' profitability using panel regression. Findings from the analysis reveal a significant linear relationship between WCM and firms' profitability. Similarly, Ahmed (2013) evaluates the nexus between working capital management and performance of firms quoted on Karachi Stock Exchange market. Findings from OLS analysis indicate positive nexus between WCM and firm's performance.

In addition, Amponsah-Kwatiah and Asiamah (2020) examine the impact of WCM on profitability of manufacturing enterprises in Ghana. Using a quantitative approach to research, data were analysed with E-views 9.0 statistical package and the results exhibit that components of WCM (i.e., inventory, cash, account receivables and payables) positively affected profitability in relation to ROA and ROE. In a related development, Ajayi et al. (2017) assess the impact of WCM on financial performance of listed firms that are into manufacturing of consumer goods in Nigeria. With the aid of purposive sampling technique, 15 firms were investigated and the outcome reveals that efficient WCM has enormous positive impact on financial performance of the firms. Specifically, the outcome indicates a positive link between average collection period and financial performance.

Tony-Obiosa and Ibama (2021) study the influence of WCM on profitability of SMEs in Rivers State, Nigeria. Using SPSS, results of the regression analysis reveal that components of WCM (cash, accounts payable and receivable) are positively related with profitability of SMEs in term of ROI and earnings per share. Similarly, Folajinmi, and Peter (2020) evaluate the practice of financial management and SMEs performance in Ogun State, Nigeria using a sample of 150 poultry farmers. The analysis indicates working capital management is significantly related with profitability of SMEs in poultry farming.

Also, Okoror et al. (2022) investigate the effects of WCM on financial performance of listed manufacturing firms in Nigeria using panel data estimation techniques. Results of the analysis reveal that WCM is positively and significantly related with excellent financial performance of the firms. Thus, evidence reveals that WCM impact enormously on firms' performance across the globe. However, Anabis et al. (2013) indicate low application of WCM amongst SMEs in Western Uganda as finding demonstrates an average mean of 2.19 only.

Majority of empirical evidence in the preceding paragraphs indicate positively significant relationship between WCM and firm performance. This may be consistent with the tenets of self-efficacy theory as it demonstrates the ability and competence of the firms in managing working capital efficiently. It goes thus to imply that if owners/managers of small enterprises are confident in their ability and competence to efficiently implement the principles of working capital management, they may perform better than those who do not. Therefore, the study hypothesizes that: *WCM is positively related with firms' financial performance*

3. Methodology

This investigation which was based on a causal-effect research design, gathered data on a cross-sectional survey of small enterprises in Kano, Nigeria. This study consider Kano appropriate location because it is regarded as the second largest city in Nigeria and a viable business centre where people from different states and countries gather to trade (Taiwo, 2017). To select an enterprise for participation in the survey, the number of employees served as a criterion (i.e., between 10 and 49 employees). The survey was self-administered or hand delivered because there is incidence of very low response rates associated with research that utilized electronic or mailed survey (Rua et al., 2018). Adopting a purposive sampling, 520 small enterprises were contacted and served the questionnaire. Two weeks later, a

follow up was made and 223 completed questionnaires were retrieved. A second follow up was made a week later and 125 copies of the questionnaire were returned. Put together, a total of 348 completed questionnaires were retrieved. By calculation, the figures represent a response rate of 67%.

The survey was fashioned to allow for only a participant (i.e., owner/manager) per enterprise to respond to all the questionnaire items. In this regard, it is necessary to take appropriate measures against likely common method bias. The guidelines as suggested by Podsakoff et al. (2003) were followed. For example, respondents' anonymity was guaranteed, the measurement items were varied, and the instrument was designed in a way that respondents could hardly predict relationships between the variables. Also, to evaluate non-response bias, t-test analysis was performed in line with Armstrong and Overton (1977) to compare the earliest and latest pattern of responses for each variable in which the outcome exhibited absence of significant variance between those that responded early and late respondents ($p < 0.01$).

The measuring instruments for working capital management was adapted from Folajinmi and Peter (2020) and firms' financial performance was adapted from Bamfo and Kraa (2019). While working capital management was measured with six items such as "we allow a moderate credit sales to reliable customers only", firms' financial performance was measured with seven items such as "our return on investment has been impressive over the years". All the indicators were scaled on five-point Likert scale spanning from one (1) representing strongly disagree to five (5) for strongly agree. Data generated from the survey were analysed with the aid of a variance-based structural equation modelling called partial least square (SmartPLS version 4.9.2) to test the hypothesis. PLS-SEM does not necessarily require large sample size for dependable outcome (Hair et al., 2017). Besides, it has the ability for predicting cause-effect relationships between constructs. Thus, making it highly suitable for this study.

4. Results

Measurement Model

Figure I and Table I present output of the measurement (outer) model.

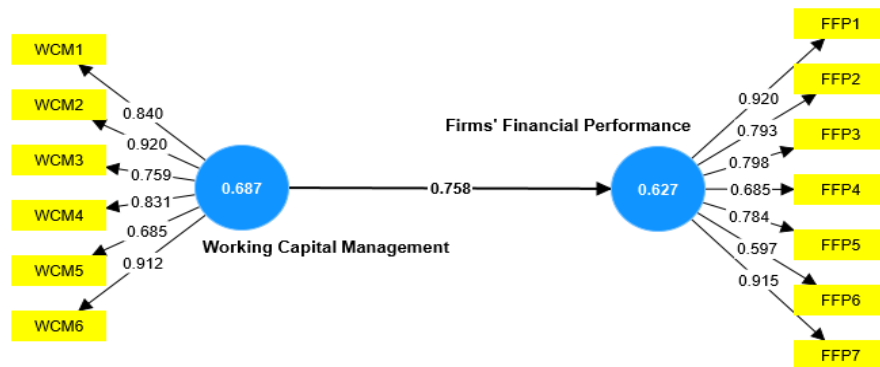


Figure I: Measurement (outer) model

Table I: Reliability and Convergent Validity

Construct	Item	Loading	AVE	Cronbach	CR
Working Capital Management	WCM1	0.840	0.687	0.908	0.929
	WCM2	0.920			
	WCM3	0.759			
	WCM4	0.831			
	WCM5	0.685			
	WCM6	0.912			
Firm's Financial Performance	FFP1	0.920	0.627	0.898	0.920
	FFP2	0.793			
	FFP3	0.798			
	FFP4	0.685			
	FFP5	0.784			
	FFP6	0.597			
	FFP7	0.915			

Source: Authors' Computation

Both Figure 1 and Table I, showcase the individual indicator loading on their respective latent constructs. The indicators are found to be reliable as majority of outer loadings exceeded 0.70 which is the threshold as suggested in Hair *et al.* (2017). Meanwhile, Hair *et al.* (2017) cautioned researchers to consider the values of average variance extracted (AVE) and composite reliability (CR) before deleting indicators with outer loadings between 0.40 and 0.70. Therefore, the fifth indicator of WCM, as well as the fourth and sixth indicators of FFP were retained because the thresholds for AVE, and CR were already satisfactory. In the same vein, the coefficient of Cronbach Alpha was achieved. Further, assessment of discriminant validity via Fornell-Larcker assessment criterion and heterotrait-monotrait (HTMT) ratio. Still, the outcome for both Fornell-Larcker and HTMT ratio were satisfactory as recommended by Fornell-Larcker (1981) and Kline (2011) respectively.

Evaluation of Structural Model

Figure 2 represents the pattern of correlations between WCM and firms' financial performance. The tie between WCM and financial performance of small enterprises was evaluated through analysis of path coefficient. The results highlighted in Figure 2 indicate statistically significant positive link between WCM and firms' financial performance ($\beta=0.758$; SE = 0.23; t – value = 33.436; p – value = 0.000; LL=0.715; UL=0.790). SE represents standard error, LL – lower limit at 5% and UL – upper limit at 95% confidence intervals bias corrected. Thus, the results provide support for the hypothesis stated earlier. Also, the results reveal that all indicators are statistically significant in loading on their respective latent constructs as all p-values are significant at less than one per cent ($p<0.01$). Further, the coefficient of determination (R^2) show that working capital management accounted for 57.5% (0.575) variation in firms' financial performance. This proportion of variance explained in firms' financial performance is regarded as substantial based on Cohen's (1988) classification.

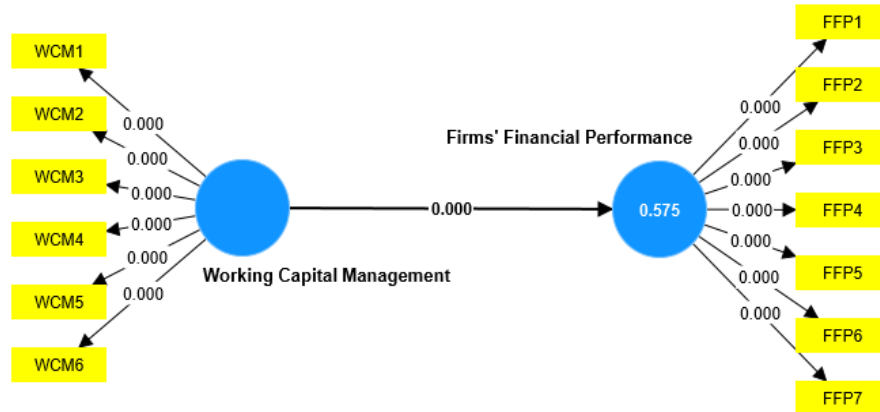


Figure 2: Structural model

WCM is concerned with maintaining prime liquidity level which may only be achieved through close monitoring and controlling elements of current assets and current liabilities such as inventory, account receivable, cash, account payable, marketable security (Hossin & Begum, 2020; Ojeani, 2014). Based on this, the current study tentatively stated that WCM would impact positively on firms' financial performance.

As predicted, findings of the study demonstrated that WCM impacted significantly on firms' financial performance. The implication is that the more small enterprises are able to maintain a balanced level of cash in hand, inventory, account receivable, marketable securities, cash at bank, as well as account payable, short-term loans, the better and higher the financial performance and vice versa. Put differently, the outcome of this study supposes that sound WCM is possibly going to boost firms' financial performance.

The findings align with tenets of self-efficacy theory which postulates that everyone possess the ability and competence to succeed in any endeavour provided there is level playground to achieve desired specific goals or outcomes (Bandura, 1977). This theory suggests that the more owners or managers of small enterprises are confident in their ability and competence to efficiently implement the principles of working capital management, the higher the financial performance of their firms than those who do not.

To compare this finding with prior empirical evidence, the significant positive link between WCM and financial performance is consistent with a number of prior studies. For instance, Folajinmi, and Peter (2020), Prempeh and Peprah-Amankona (2019), as well as Tony-Obiosa and Ibama (2021) reported significant positive relationship between WCM and profitability. Ajayi et al. (2017) and Okoror et al. (2022) found significant positive nexus between WCM and financial performance. Also, Ahmed (2013) revealed that effective WCM impacted positively on firms' performance.

Implications

It is noted that most studies in Nigeria focus attention in examining the entire category of enterprises either as MSMEs or SMEs. But then, as argued earlier, the distinction in staff strength and value of assets between these ventures might be misleading in terms of research if not treated separately. Based on this line of argument, this study adds to stock of knowledge by investigating the link between WCM and small enterprises' financial performance only. In addition to this, the study offers fertile research directions to further investigate the effect of WCM on firms' financial performance.

In another perspective, owners or managers of small businesses would appreciate the need to incorporate WCM (a component of financial management practices) into their operational processes. In doing so, it would create avenue for effective and efficient allocation of financial resources among competing elements of current assets and current liabilities such as inventory, account receivable, cash, account payable, marketable security. With this in place, small enterprises would not experience liquidity issues that may threaten smooth operation of the enterprise. To policymakers, the study offers robust policymaking directions to support activities of small enterprises in the aspect of financial management. Investors (creditors) too are not left out as this study may help in making credible or wise decision pertaining to small businesses. As a result, they will flourish to engage more people and in turn curb unemployment and poverty rates, as well as improve living standard, and GDP in the economy.

5. Conclusion and Recommendation

From the foregoing, this study contributes to empirical evidence regarding the prominence financial management practices with specific emphasis on working capital management as it relates with firms' financial performance. Also, this study provides knowledge about the influence of WCM on financial performance of small enterprises that may help small business owners or managers, investors, and policymakers to make better decisions. Therefore, it may not be out of place to conclude that WCM exerts tremendous influence on the financial performance of businesses with staff strength between 10 and 49, and asset base between 5 and 49 Million Naira. Thus, findings of this study suggest that small enterprises should strive to maintain effective WCM to improve their financial performance.

Limitations and Direction for Future Research

The current study only focused on WCM as a component of financial management practices. WCM ensures that enterprises maintain optimum level of liquidity at all times for uninterrupted conduct of business operation. Thus, sound WCM is crucial in pursuit of business goals and/or objectives. However, future research could include other elements such as capital structure management, capital budgeting management, and dividend policy in predicting firms' financial performance. Besides, working capital management was treated as a unidimensional construct in this study instead of a multi-dimensional construct to evaluate the individual effects of cash, inventory, accounts receivable, marketable securities, accounts payable, etc. on firms' financial performance. Therefore, future research may explore this research direction.

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