

Working capital policy of newly incorporated firms

WCP of newly
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firms

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Abstract

Purpose – The present study examines the initial working capital policy (WCP) and its evolution for newly established manufacturing firms.

Design/methodology/approach – Using panel data of 162 firms over a period of 10 years, the study analyses the persistence-cum-convergence in WCP over the subsequent years through descriptive analysis and difference of means test. Further, the prevalence of β – convergence, and σ -convergence has been examined using standard least squares regression, dynamic panel analysis and the Wald test.

Findings – The results indicate that sample firms continue to follow the initial WCP in the subsequent years with a gradual convergence in the WCP. Alternatively, the firms with aggressive (conservative) WCP at the time of incorporation will continue following it. Further, the firms with aggressive initial WCP have witnessed higher growth than those with conservative initial WCP.

Research limitations/implications – Findings will assist managers and practitioners to understand the dynamics of WCP over the life cycle of the firm and select appropriate WCP as certain policies lead to certain growth paths.

Originality/value – Though working capital management has been recognized as a critical managerial decision, limited research is available on its evolution, especially for newly established manufacturing companies in an emerging economy. Current research attempts to fill this gap and provide valuable insights for the effective management of liquidity.

Keywords Working capital, Evolution, Liquidity, Manufacturing firms, Emerging market

Paper type Research paper

1. Introduction

Working capital management, especially in a manufacturing firm, has been considered as one of the crucial business decisions (Fazzari *et al.*, 2000) as it is a function of product mix, length of the operating cycle, activity level and credit terms (Bhalla, 2014). Among various finance decisions, the working capital decision stands quite different as it requires continuous monitoring and alterations based on the changes in the business environment. The decisions taken by firms concerning working capital lead to the adoption of a specific type of working capital policy (WCP), which is further sub-grouped as working capital investment policy (WCIP) and working capital financing policy (WCFP) (Bhalla, 2014). Provided the external dynamics, continuous evaluation of WCP is needed for retention or alteration and, in either type of decision, the proportion and pace of retention or alteration need to be studied. Extant literature has studied working capital as one of the determinants of profitability

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