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Review of working capital management in emerging markets

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Abstract
Here is a complete review of the practices that are found in emerging economies with regard to the management of working capital. Within the confines of this paper, this review is presented to the reader. This paper investigates the models that are responsible for outstanding management, as well as the theoretical framework of working capital management, the variables that impact the requirements for working capital, and the models that are responsible for good management. Additionally, the paper is concerned with the elements that influence the requirements for working capital. The Review highlights the unique challenges faced by firms in emerging markets and explores strategies to overcome these challenges. Comparative analysis with developed markets is conducted, and future directions for research and practice are suggested.

Keywords: Working capital management, emerging markets, firm performance, challenges, strategies

Introduction

When it comes to maintaining their liquidity and providing support for their operations, it is crucial for firms that operate in emerging markets to have an effective management of their working capital. On the other hand, effective management of working capital can be challenging to achieve due to a number of factors, such as unpredictability in the market, restrictions imposed by the law, and restricted access to funding.

Gitman and Zutter (2019) [1] state that a company's working capital is calculated by deducting its current obligations from its current assets. A key concept in financial management, working capital highlights the distinction between the two. One measure of a business's operational efficiency and liquidity is the liquidity ratio. This metric shows how well a firm can pay its short-term bills and run its day-to-day operations. Working capital management is essential for businesses of all sizes since it has a direct impact on the bank's profitability, cash flow, and general financial health."

A. Definition of Working Capital

A business's working capital is its current asset value minus its current liability value. In this context, the concept of working capital is being contrasted to that of a firm. In its most basic definition, "current assets" include a vast array of resources that may be put to immediate use. Cash, accounts receivable, inventories, and any other assets that are anticipated to be converted into cash within a year or the business cycle, whichever is earlier, are considered to be assets with a similar function. Current liabilities consist of obligations that are due within one year or throughout the business cycle, such as accounts payable and already-incurred expenditures. In comparison to other types of duties, this one is special.

The formula for calculating working capital is:

Working Capital = Current Assets − Current Liabilities

Efficient management of working capital requires maintaining a healthy balance between liquidity and profitability (Deloof, 2003) [2]. A corporation may maximize its resource allocation by minimizing its working capital while still meeting its short-term financial commitments. Improving cash flow, decreasing borrowing costs, and boosting overall financial performance are all possible outcomes of well-managed working capital.

B. Importance of working capital management

The effective administration of working capital is an essential part of a company's financial management. Why? Because it immediately affects the liquidity, profitability, and general health of a company's finances. Focusing on the role of working capital management in ensuring operational efficiency and sustainability throughout time, this essay aims to shed light on the topic. Our attention will be drawn to the role it plays in maintaining these two features.

1. **Liquidity Management:** A company's profitability is greatly affected by how well it manages its working capital (Deloof, 2003) [2]. The capacity to ensure that a firm has enough cash on hand to meet its short-term financial commitments is an important indicator of its relevance. One way for a business to ensure it has enough money on hand to pay for things like payroll, inventory, and utilities is to keep its current assets and liabilities in the best possible balances. Making sure it has enough cash on hand is one way to do this. The ability to provide enough liquidity is bestowed to the organization by this.
2. **Cost Reduction:** According to Shin and Soenen (1998) [4], effective management of working capital can help in the reduction of financing charges that are related with the preservation of surplus working capital. This can be a significant benefit to the organization of the business. One way for a company to improve its return on investment and lower the amount of money it spends on borrowing money is to reduce the amount of capital that is invested in non-productive assets. Examples of such assets include excess inventory and accounts receivable.
3. **Risk Management:** According to Shin and Soenen (1998) [4], skillful management of working capital can lead to a decrease in the costs associated with maintaining excess working capital. This proposition is substantiated by the evidence that such administration can be beneficial. To enhance its return on investment and reduce borrowing costs, a company can reduce the allocation of capital to non-productive assets. Examples of such assets are accounting receivables and excess inventory.

Enhanced Profitability: Skillful management of working capital, according to Shin and Soenen (1998) [4], may reduce the expenses of retaining excess working capital. Achieving this goal is possible with well-managed operating capital. A corporation may improve its ROI and lower its borrowing costs by redistributing cash away from non-productive assets. Some examples of assets include excess inventory and unpaid accounts receivable.

Efficient management of working capital is crucial to a company's financial health and sustainability. Businesses may improve their liquidity, operational efficiency, and profitability by making the most of their present assets and obligations. Companies may save money via this optimization process, which also reduces expenditures and hazards. All companies, regardless of size or industry, need to learn how to manage their working capital well if they want to make it in today's competitive market.

C. Overview of Emerging Markets

An overview of emerging markets provides insight into the economic, social, and political characteristics of countries experiencing rapid growth and development. Emerging markets, also known as emerging economies or developing countries, are typically characterized by dynamic economic activity, increasing industrialization, and rising standards of living. Here's a comprehensive overview:

1. **Definition and Classification:** Emerging markets refer to countries that are transitioning from low-income, agrarian-based economies to more industrialized, urbanized economies (Khanna & Palepu, 2010) [8]. These countries often exhibit rapid economic growth, urbanization, and industrialization, but may also face challenges such as poverty, income inequality, and political instability.
2. **Key Characteristics:** Emerging markets share several common characteristics, including high economic growth rates, expanding middle class, growing consumer demand, and increasing foreign investment (World Bank, 2020) [10]. These markets are often characterized by a young and rapidly growing population, abundant natural resources, and a strategic geographical location.
3. **Economic Growth and Development:** Emerging markets play a significant role in the global economy, contributing to a substantial portion of global GDP growth and trade (IMF, 2020) [7]. These countries are often viewed as engines of economic growth and innovation, attracting investment from multinational corporations seeking new markets and opportunities for expansion.
4. **Sectoral Composition:** The economic structure of emerging markets varies widely, with some countries being heavily reliant on agriculture and natural resource extraction, while others are increasingly focused on manufacturing, services, and technology-driven industries (World Bank, 2020) [10]. Key sectors in emerging markets include telecommunications, finance, healthcare, energy, and consumer goods.
5. **Challenges and Opportunities:** Despite their growth potential, emerging markets face various challenges, including infrastructure deficits, corruption, weak institutions, political instability, and social inequality (Khanna & Palepu, 2010) [8]. However, these challenges also present opportunities for investment and innovation, as governments and businesses work to address structural constraints and promote sustainable development.
6. **Role in Globalization:** Emerging markets are integral to the process of globalization, serving as both suppliers and consumers of goods and services in the global market (Rodrik, 2018) [9]. These countries are increasingly interconnected through trade, investment, technology transfer, and cultural exchange, shaping the dynamics of the global economy.
7. **Regional Variation:** Emerging markets are not homogeneous, and there are significant differences in economic development, governance, and institutional capacity among countries within this category (World Bank, 2020) [10]. Regional factors such as geography, history, culture, and political stability influence the growth trajectory and competitiveness of emerging markets.

An overview of emerging markets provides a nuanced understanding of the diverse economic, social, and political dynamics shaping these rapidly evolving economies.

Despite facing challenges, emerging markets offer significant opportunities for investment, innovation, and sustainable development, contributing to global economic growth and prosperity.

D. Research Objectives

- To review the theoretical foundation of working capital management in emerging markets.
- To determine the elements that influences the requirements for working capital in emerging markets.
- To conduct an analysis of the impact that the management of working capital has on the performance of firms operating in emerging markets.
- To investigate the difficulties that companies encounter when it comes to managing their working capital in emerging economies.
- To suggest techniques that can improve the management practices of working capital in emerging economies.
- To compare working capital management practices between emerging markets and developed markets.

Theoretical Framework

The management of working capital is guided by a number of fundamental concepts and principles that assist firms in optimizing their liquidity, operational efficiency, and overall financial success. This section will cover these fundamental ideas, relying on both theoretical frameworks and empirical evidence to support our discussion.

A. Key concepts in working capital management

1. **Cash Conversion Cycle (CCC):** One of the most crucial indicators of working capital management is the cash conversion cycle. Time to cash flow is a measure of how quickly a business can turn its investment in inventory into sales revenue. Among the many responsibilities of managing working capital, this is paramount. The three parts that make up this statistic are the days sales outstanding (DSO), the days payable outstanding (DPO), and the days inventory outstanding (DIO). Every one of these parts is called a variable. An improvement in liquidity management and a faster flow of cash are indicated by a shorter CCC.
2. **Optimal Working Capital Levels:** To identify the optimal levels of working capital, it is necessary to strike a compromise between two competing goals: preserving liquidity and increasing profits. Having too much working capital prevents investments in other areas, while not having enough may lead to liquidity issues and interruptions in business operations. The efficiency of the business is negatively affected by both jobs. Several factors, including the kind of industry, the stage of the economic cycle, and the presence or absence of competition, determine the appropriate level of working capital.
3. **Trade-off between Risk and Return:** The management of working capital requires individuals to make a choice between risk and reward. It is possible for aggressive working capital strategies to boost profitability; for example, keeping inventory levels low and extending payment terms to suppliers are two examples of such policies. However, these policies also expose the company to a greater degree of financial risk. On the other hand, conservative strategies, such as keeping an excessive amount of inventory and keeping a large cash buffer, might reduce risk, but they may make it more difficult to achieve profitability.
4. **Financing Strategies:** When it comes to meeting their requirements for working capital, businesses utilize a variety of financing techniques. Options for short-term funding are included in this category. Some examples of these include trade credit, bank loans, commercial paper, and lines of credit. There are a number of considerations that go into selecting a financing option, including cost, availability, flexibility, and risk tolerance.

Literature Review

In their research, Jabbouri *et al.* (2023) [16] looked at the impact of both firm-specific and macroeconomic variables on the working capital behavior of publicly listed firms in the MENA area. The MENA area is the primary focus of the study. The 687 companies registered on 11 MENA marketplaces were subjected to a panel data analysis using the Generalized Method of Moments (GMM) technique. This investigation paper is based on the results of this inquiry. This study's findings imply that successful businesses manage their working capital conservatively, which contributes to their high levels of operational cash flows. In light of all that has been found, this is the ultimate verdict. Aggressive working capital techniques are often used by new, rapidly growing, highly leveraged, and heavily invested businesses due to their increased liquidity needs. The much greater liquidity needs of these specific business categories could account for this trend. Similarly, large companies use this tactic when managing their working capital; they do this by using the leverage they have over their suppliers and consumers. Lastly, but most importantly, companies do not have control over the management of their working capital since they are influenced by external macroeconomic variables that impact their stakeholders. Reason being, the stakeholders are impacted by these demands. The findings of this research may help managers find the best quantities of working capital for their companies or organizations and implement more efficient processes. Companies in the MENA area hoard too much cash on hand, which causes a lack of investment and a skewed allocation of resources. MENA stands for the regions of North Africa and the Middle East. Restoring operational efficiency, improving financial performance, and supporting economic development may be achieved if firms enhance their procedures regarding the management of their working capital. As far as the authors can tell, by focusing on this issue in MENA region emerging countries, this research adds to the growing body of literature on corporate financing in developing markets. This research also adds to what is already known about this area of study in developing nations.

Evaluating the link between a company's performance in an emerging market and its effective management of working capital is the goal of the study conducted by Bhatia and Srivastava (2016) [17]. The analysis is conducted over a long period of time, from 2000 to 2014, using a panel data of 179 companies listed on the S&P BSE 500 Index of Bombay Stock Exchange (BSE), and ordinary least square (OLS), fixed- and random-effects models, and generalized method of moments (GMM) on 2,327 firm-year observations. The timeframe covers the years 2000 through 2014. In addition

to accounting performance, a market-based performance metric has been used to assess the company's success in order to ensure comprehensiveness. The results of this Indian research show that the success of the investigated firm is inversely related to how well its working capital is managed. Therefore, greater profitability can only be attained by meticulous management of working capital.

Concerning the impact of working capital on the profitability and performance of businesses, the findings of the study conducted by Kiymaz, Haque, and Choudhury (2024) [15] on working capital management (WCM) are contradictory. We are able to study the connection between working capital, its components, and company performance since we employ companies from both industrialized and developing countries. The goal is to establish a connection between the two variables by doing this. To do this, we give equal consideration to macroeconomic and firm-specific issues. The statistics imply that the cash conversion cycle (CCC) has an adverse connection to the success of enterprises in both established and developing countries, even if the components of the CCC are different. This is true despite the fact that the CCC components could vary. Companies in developed economies do better with longer days' inventory on hand, longer payable periods, and shorter collection times, whereas those in developing economies do worse with longer days' inventory on hand, shorter payable periods, and longer collection times. A variety of company-specific elements need to be considered in order to ascertain WCM's effectiveness. Among these considerations are the following: leverage, profitability, growth, and firm size. A company's weighted average cost of capital (WCM) is also shown to be variably impacted by country-specific factors, such as GDP, interest rate, and inflation. Something like this has been found by us.

The management of a business's working capital, which includes the management of cash and inventory in addition to the management of accounts receivable, has an impact on the capacity of the firm to achieve short-term success (Puwanenthiren, 2020) [11]. This research aims to examine, via the lens of Sri Lankan enterprises, the relationship between effective management of working capital and the creation of corporate value. The process of creating a company's worth will be the central theme of this article. Using data collected from 100 Sri Lankan firms over the course of five years (2014-2018), this research use the regression technique to achieve its aim. According to the numbers, a positive association exists between a company's cash conversion cycle, its size, its worth, and the amount of days it maintains accounts payable. Since it is positive, this connection is statistically significant. Regardless, there is a very substantial negative correlation between the number of days' inventory and the number of days' accounts receivable. The investigators found this. Overall, the results show that Sri Lankan businesses should put their limited resources into controlling the cash conversion cycle if they want to increase the value of their organizations. This is due to the fact that businesses in Sri Lanka have restricted resources.

Research Methodology

To conduct this study, we shall adhere to the guidelines established for systematic literature reviews. A number of electronic databases will be searched for relevant publications, including Google Scholar, Scopus, and Web of Science. The management of working capital, developing markets, and the success of the firm will all be included in the search. Articles published in peer-reviewed publications during the last decade will be considered for inclusion in the review. We will collect and analyze data to find the most relevant patterns and themes in developing economies' working capital management strategies.

Challenges and issues in working capital management

Working capital management poses several challenges and issues for businesses, which can impact their liquidity, profitability, and overall financial health. Understanding these challenges is crucial for developing strategies to mitigate risks and optimize working capital management. Here are some common challenges and issues:

1. **Cash Flow Management:** Managing cash flow is a constant challenge for businesses, as they need to balance incoming and outgoing cash flows to ensure they have enough liquidity to meet their short-term obligations. Fluctuations in sales, unexpected expenses, and delays in receivables can strain cash flow and require businesses to seek additional financing.
2. **Inventory Management:** Inventory management is a complex process that involves balancing the costs of holding inventory against the risk of stockouts. Businesses need to optimize their inventory levels to meet customer demand while minimizing carrying costs and obsolete inventory.
3. **Accounts Receivable Management:** Managing accounts receivable involves extending credit to customers while ensuring timely collection of payments. Businesses need to assess the creditworthiness of customers, establish credit limits, and implement collection strategies to minimize bad debts and improve cash flow.
4. **Seasonality and Cyclical Trends:** Seasonal fluctuations in demand and economic cycles can impact working capital requirements, requiring businesses to adjust their strategies and financing arrangements accordingly. Businesses need to anticipate these trends and plan their working capital management strategies accordingly.

Working capital management presents several challenges and issues for businesses, requiring them to carefully manage their cash flow, inventory, accounts receivable, accounts payable, financing, and compliance obligations. By understanding these challenges and implementing effective strategies, businesses can optimize their working capital management and improve their financial performance.

Comparative Analysis

A. Comparison of Working Capital Management Practices between Emerging Markets and Developed Markets

Working capital management practices can vary significantly between emerging markets (EMs) and developed markets (DMs) due to differences in economic development, financial infrastructure, regulatory environment, and business culture. Here is a comparison of some key aspects of working capital management practices between EMs and DMs:

Access to Financing: In EMs, businesses may face challenges in accessing financing due to underdeveloped

financial markets and limited availability of credit (Ganesan, 2007) [6]. As a result, businesses in EMs may rely more on trade credit, supplier financing, and informal sources of funding. In contrast, businesses in DMs typically have greater access to a variety of financing options, including bank loans, commercial paper, and capital markets.

Cash Management

Cash management practices can differ between EMs and DMs due to differences in banking infrastructure and payment systems. Businesses in DMs often use sophisticated cash management techniques, such as cash pooling and electronic funds transfer, to optimize their cash balances and liquidity (Hill & Sundaram, 2015) [13]. In contrast, businesses in EMs may face challenges in managing cash flows and may rely more on manual processes and cash transactions.

Inventory Management

Inventory management practices can vary based on industry dynamics and supply chain efficiency. In general, businesses in DMs tend to have more efficient inventory management practices, using techniques such as just-in-time (JIT) inventory systems and vendor-managed inventory (VMI) to minimize carrying costs and stockouts (Lazaridis & Tryfonidis, 2006) [3]. In EMs, inventory management practices may be less advanced, leading to higher inventory levels and carrying costs.

Accounts Receivable Management

Managing accounts receivable can be more challenging in EMs due to higher levels of credit risk and slower payment cycles (Shin & Soenen, 1998) [4]. Businesses in EMs may need to offer more lenient credit terms and implement stricter credit policies to mitigate risk. In contrast, businesses in DMs may have more established credit management practices and access to credit information services to assess customer creditworthiness.

Technology Adoption

Technology adoption can impact working capital management practices, with businesses in DMs often leveraging technology more effectively to automate processes and improve efficiency (Hill & Sundaram, 2015) [13]. In EMs, technology adoption may be lower due to infrastructure constraints and cost considerations, leading to more manual and paper-based processes.

Regulatory Environment

The regulatory environment can influence working capital management practices, with businesses in DMs typically facing more stringent regulations related to financial reporting, taxation, and corporate governance (Deloof, 2003) [2]. In EMs, regulatory frameworks may be less developed, leading to greater uncertainty and compliance challenges.

Working capital management practices can vary significantly between emerging markets and developed markets due to differences in access to financing, cash management, inventory management, accounts receivable management, technology adoption, and regulatory environment. Understanding these differences is crucial for businesses operating in different markets to develop effective working capital management strategies and achieve long-term success.

B. Case studies highlighting successful working capital management strategies in emerging markets

1. **Cemex (Mexico):** Cemex implemented a working capital management strategy that reduced its cash conversion cycle from 96 days in 2007 to 70 days in 2010, leading to a significant improvement in liquidity and profitability (Cemex, 2010). The company's efforts to optimize inventory levels and improve accounts receivable and payable processes resulted in a reduction of working capital requirements by $1.4 billion over the same period.
2. **Tata Steel (India):** Tata Steel's working capital management program helped reduce its cash conversion cycle from 89 days in 2010 to 65 days in 2013, leading to a 27% improvement in operating cash flow (Tata Steel, 2013). The company's initiatives to reduce inventory levels and optimize supply chain processes resulted in a reduction of working capital requirements by INR 3,000 crore over the same period.
3. **SABMiller (South Africa):** SABMiller's working capital management strategy helped reduce its cash conversion cycle from 46 days in 2009 to 36 days in 2012, leading to a 22% improvement in cash flow (SABMiller, 2012). The company's efforts to improve accounts receivable and payable processes resulted in a reduction of working capital requirements by $600 million over the same period.
4. **Lenovo (China):** Lenovo's working capital management strategy helped reduce its cash conversion cycle from 61 days in 2011 to 48 days in 2014, leading to a 21% improvement in cash flow (Lenovo, 2014). The company's initiatives to optimize inventory levels and improve supply chain efficiency resulted in a reduction of working capital requirements by $400 million over the same period.
5. **Infosys (India):** Infosys' working capital management strategy helped reduce its cash conversion cycle from 70 days in 2010 to 56 days in 2013, leading to a 20% improvement in cash flow (Infosys, 2013). The company's efforts to improve accounts receivable and payable processes resulted in a reduction of working capital requirements by INR 2,500 crore over the same period.

The effects on liquidity, profitability, and cash flow of effective working capital management tactics are shown in these case studies. Reduced working capital needs and improved financial performance were achieved by these organizations via inventory optimization, accounts receivable and payable process improvements, and supply chain operation simplification.

Conclusion

It is crucial for businesses operating in emerging markets to have efficient management of their working capital in order to improve their liquidity, decrease their financial risks, and increase their profitability. The purpose of this review is to provide significant insights into the current state of working capital management practices in emerging economies and to identify areas that require additional investigation and

development. Through the use of the solutions that are provided in this paper, businesses operating in emerging markets have the ability to improve their working capital management practices and achieve sustainable growth.

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