AN INTERNATIONAL STUDY OF MANAGEMENT PERCEPTIONS OF THE WORKING CAPITAL PROCESS

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Abstract. Working capital literature is rather limited and the process of managing short-term resources is not understood well by academicians. In contrast, corporate managers are continuously involved in the working capital decision-making process, but their perspective is limited to the practices within their firm. In order to fill this gap in the working capital literature, a study of management perceptions of the working capital process was undertaken. A survey was used to collect information from a sample of marketing, production, and financial executives in large corporations in Belgium, France, India, and the United States. The study interprets management ranking of working capital objectives and indicates the need to improve financial planning models to include explicitly short-run objectives; further, predictability of cash inflows and outflows is examined and the potential factors affecting predictability are evaluated. Finally, this study examines management perceptions of long-range objectives in order to provide a proper perspective to the short-run financial planning.

INTRODUCTION

A major portion of management time is occupied in managing working capital. Despite heavy management involvement, only peripheral research interest in studying the working capital management process has been shown in the literature. This occurs for several reasons. Decisions dealing with working capital occur frequently and they are routine in nature; thus, their individual impact is insignificant. Second, unlike decisions related to capital investment, these routine decisions are reversible over time. To measure and control its aggregated impact, working capital decision making requires an immediate feedback system; however, given its relatively insignificant impact in the

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short run, dynamic analyses are usually not deemed worthwhile. Third, a major problem in managing working capital is forecasting cash flows. Clearly, inputs for this task are not strictly financial. Often financial aspects of a decision are virtually eclipsed by marketing (credit granting) or production (inventory) decisions which have a more direct impact on a company's cash flows. Finally, although activities involving working capital are interrelated with long-term financial planning, in reality either they are treated independently or the former is subsumed under the latter. The net result of these disparate and often contradictory tendencies has been modest progress in understanding the working capital management process.

Although financial theory does not postulate any reasons why short-run financial management objectives should be distinct from the long-run objectives in a firm, a review of the literature indicates a lack of consensus concerning the primary objective of working capital management. In light of this contradictory tendency, one objective of the paper is to study managements' perceptions of the objective of the working capital processes. Because working capital decision making is closely related to the total financial planning system, the study will seek, as a by-product, linkages between short- and long-run financial planning objectives.

It is widely recognized that unexpected events which alter anticipated cash flows are a primary cause of working capital crises. The predictability of cash inflows and outflows is the most basic concern in managing working capital. Thus, a second objective is to study the predictability of cash inflows and outflows and to determine the variables that create instability in the system.

For comparative purposes we examined the working capital management process for large manufacturing companies in Belgium, France, India, and the United States. This diverse information will enrich our understanding of the short-run financial planning process and aid in the construction of a generalized model (provided it is needed) for working capital planning.

Thus, this article has three objectives: to discover management perceptions of the objectives of the working capital process; to determine management perception of the predictability of cash inflows and outflows as well as to evaluate the variables that create deviations in cash flow; and to compare and contrast perceived working capital practices among a set of large companies from four countries. The paper will first present the methodology followed in the study. The next two sections are devoted to analyses of working capital objectives and predictability of cash flows. Interspersed throughout these two sections are observations concerning the similarities and differences in the working capital practices in various countries. Finally, analysis of the perceived relationships between long-run and short-run objectives is presented in Appendix A.

The first stage of this project was to interview several corporate executives concerning the short-run financial decision-making process in their firms. These interviews provided the background for designing a questionnaire to study managements' perceptions of the working capital process. The questionnaire was pretested and the executives involved in the pretest were interviewed in order to modify the questionnaire.

It is recognized that management of working capital varies substantially among industrial, distribution, and service industries; therefore, it was decided to use the Fortune 500 industrial companies as the universe of the United States companies. Comparable large industrial corporations in Belgium, France, and India were also selected. Because working capital decision making involves several areas of a corporation, it was essential to acquire responses from management in the areas of production, marketing, and finance; thus, four questionnaires were sent to the treasurer of each company. The treasurer was asked to complete one questionnaire and have the comptroller and an executive from production and marketing departments each complete an additional questionnaire.