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The Relationship Between Corporate Governance And Working Capital Management Efficiency Of Firms Listed At The Nairobi Securities Exchange

Simon M. Kamau[1*] Kefah A. Basweti[2]
[1] Faculty of Commerce, Department of Accounting Finance and Management Science, Egerton University, Nakuru Town Campus College, P.O Box 13357, Nakuru-Kenya
[2]Lecturer, Faculty of Commerce, Department of Accounting Finance and Management Science, Egerton University, Nakuru Town Campus College, P.O Box 13357, Nakuru-Kenya
[*]E-Mail of the corresponding author: simonms.99@gmail.com

ABSTRACT
The aim of the study was to examine the relationship between corporate governance and working capital management efficiency. The population of the study comprised all the forty two firms which had been consistently listed at the Nairobi Securities Exchange from 2006-2012. Data was collected from secondary sources. Independent one-way ANOVA test and independent t-tests were used to determine the level of significance. The results of the study indicated that there was no statistical significant relationship between corporate governance and working capital management efficiency. This study contributes to the literature on the relationship between corporate governance and working capital management efficiency.
Keywords: Corporate governance, working capital management efficiency, listed companies and Nairobi Securities Exchange.

1.1 INTRODUCTION

The relevance of corporate governance remains fairly established following the collapse of several organizations. It is recognized to play an important role in the management of organizations in both developing and developed countries. Indeed, the significance of corporate governance has increased with the separation of control from ownership in companies that are publicly held due to the conflict of interest that may arise between agents and principals (Clarke, 2007). Therefore, corporate governance is intended at safeguarding the interests of the principals from agents. Nonetheless, strong corporate governance does not only establish and maintain good corporate culture that inspires the management to make decisions that maximize the wealth of shareholders but it also ensures efficient management of a firm's resources (Wambua, 2010).

The need to optimize shareholders wealth requires corporate governance mechanisms to focus on enhancing the economic efficiency of a firm. Miringu and Muoria (2011) emphasize that the governance structure of any firm affects its ability to deal with external factors and it has an impact on its financial performance. Subsequently, well governed firms have been noted to record better performance hence good corporate governance is core in enhancing shareholders value. In this regard, Achchuthan and Kajananthan (2013) argue that corporate governance practices are strategies which are formulated in order to meet the short, medium and long term objectives of a firm as well as those of the shareholders. As a result, working capital management efficiency becomes an important mechanism for meeting the short term objectives of a firm.

According to Ganesan (2007) working capital management efficiency involves the management of short-term financing requirements of a firm. It encompasses maintaining favorable balance of working capital elements which include inventory, payables, receivables and cash balances. Filbeck and Krueger (2005) emphasize that firms are obliged to ensure working capital management efficiency so as to ensure a tradeoff between liquidity and profitability hence prevent bankruptcy. In this perspective, working capital management is considered as one of the most important function of corporate management (Achchuthan and Kajananthan, 2013). Management of working capital is the most vital factor for maintaining solvency, profitability and liquidity of a firm. Consequently, firms should take actions to obtain the best level of efficiency in managing working capital through corporate governance mechanisms. In this respect, a study on corporate governance and working capital management efficiency of firms in developing countries like Kenya can be worth.

1.2 Statement of the problem

Strong corporate governance is important especially with the current global financial crisis in order to ensure good financial management and to deal with uncertainties that characterize future business occurrences. Efficient financial management is a vital aspect of creating competitive advantage and it requires a firm to make good

decisions regarding long-term and short-term capital and to maintain solvency and liquidity (CPA Australia, 2010). Working capital management efficiency is viewed as the most important function of managing a corporation in regard to the liquidity concept. Thus, efficient working capital management decisions are strategic elements in corporate governance. Sen at el (2011) argue that efficient management of working capital is a significant component of improving profitability and competitiveness of firms'. Consequently, improving performance and competitiveness of corporations by ensuring efficient management of working capital becomes an important feature of corporate governance. In this connection, Gill and Biger (2013) conducted a study in USA and found out that corporate governance improves working capital management efficiency. In contrast, a study by Achchuthan and Kajananthan (2013) revealed that corporate governance has no influence on working capital management efficiency. Owing to these contradicting results, this study was set out to assess the relationship between corporate governance and working capital management efficiency of firms listed at the Nairobi Securities Exchange (NSE).

1.3 Main Objective of the Study

To determine the relationship between corporate governance and working capital management efficiency of firms listed at the NSE.

1.4 Specific Objectives of the Study

i. To establish corporate governance practices of firms listed at NSE.
ii. To determine the levels of working capital management efficiency of firms listed at NSE
iii. To evaluate the relationship between corporate governance and working capital management efficiency of firms listed at NSE.

1.5 Hypothesis of the study

$H_{0;}$ there is no statistical significant relationship between corporate governance and working capital management efficiency.

2.0 LITERATURE REVIEW

2.1 Corporate Governance

Cornelius (cited by Saad, 2010) defines corporate governance as the stewardship role of corporate directors to offer oversight for the strategies and goals of a company and to nurture their implementation. Thus, corporate governance may be viewed as the set of intertwining rules by which corporations, managers and shareholders govern their conduct. These rules relate to the attributes of individual companies and the characteristics that permit firms to uphold good governance practices.

Prasad (2006) defines corporate governance as the relationship that exists between different stakeholders in a firm and it defines the performance as well as the direction of a company. It is the internal arrangements that define the relationship between managers and owners of a corporation. Cadbury Committee (cited in Clarke, 2007) defined corporate governance as the system through which companies are controlled and directed. On the other hand, the World Bank views corporate governance as a means in which companies can maximize their value by meeting their legal, contractual and financial obligations (Saad, 2010).

2.2 Elements of Corporate Governance

2.2.1 The CEO and Management

Corporate governance should ensure that the management is willing and able to lead a company to fulfill its goals towards the shareholders and other stakeholders (Kleinsschnmidt, 2007). This implies that the selection of proficient managers as well as aligning managers towards maximizing shareholders wealth depends on the ability of a company to adopt good corporate governance. Saad (2010) notes that an efficient corporate governance should ensure that the selection of new CEOs and managers is transparent and formal. To do this, an organization must set-up a special committee of the board in order to ensure that candidates with the required abilities, qualifications and experiences are selected.

Corporate governance should make sure that management acts in the interests of the shareholders. Lashgari (2012) states that corporate governance should bond managers to pursue the goals of the shareholders hence ensure that they fulfill the interests of the owners. The code of corporate governance should lay emphasis on providing adequate rules so as to prevent conflicts of interests. Furthermore, corporate governance should make sure that managers are provided with transparent remuneration packages which are linked with their performance. Transparency acts as a means of supervising the managers while variable compensation plans

should serve the role of motivating the managers to maximize their long-term performance (Kleinsschnmidt, 2007).

2.2.2 Board Composition

According to Ongore and K'Obonyo (2011) board composition and processes should be accountable to the shareholders by ensuring effective monitoring and strategic guidance of a company. Additionally, the composition of the board should ensure that it is able to keenly guide the company and supervise management. Wanjau (2007) notes that for the board to be able to supervise the actions of the management and to direct the company it must be provided with sufficient independence. This can be achieved by having some members in the board who are not part of the management of the company and have no relationship with other stakeholders.

The experience and quality of board members can affect their proficiency in controlling and guiding the affairs of a company (Kleinsschnmidt, 2007). Boards consisting individual members are important elements of corporate governance. This is because they assist in ensuring that all the necessary qualifications for an efficient board are available. Furthermore, the internal structure of a board plays a significant role in ensuring effective corporate governance (Machuki and Oketch, 2010). Board members should be divided into sub-committees in order to enable them tackle specific goals. Moreover, the board should make sure that individuals in a corporation exercise their duties efficiently and effectively. This requires the board to hold frequent meetings, set agendas for the company and obtain the necessary information so as to determine which issues the board should give preference.

2.2.3 Reporting and Auditing

Auditing and reporting is one of the most important elements of corporate governance. According to Saad (2010), the board must set up an audit committee in order to monitor the accounting, reporting and auditing of financial statements. Reporting and auditing helps in solving the agency problem by assisting shareholders to monitor and control the resources of a company. Wanjau (2007) emphasizes that reporting and auditing presents the most vital role of corporate governance. This is because it helps in putting checks and balances that help shareholders in supervising the management of a company.

2.3 Global Trends in Corporate governance

According to Ongore and K'Oboyo (2011) corporate governance systems in the world are now well documented. This is due to the significant transformations that have occurred in the area of corporate governance in the past two decades due to low corporate profits as well as the collapse of many companies. Additionally, abuse of power by the top management has been perceived as the main cause of corporate failures hence the increased focus on the role of board of directors. The current debate on corporate governance is mainly focused on the powers of the board as opposed to the discretion of the management in making decisions. Furthermore, governments' play the role of regulating corporations hence boards must ensure that they comply with the laid down regulations.

2.4 Corporate Governance in Kenya

Kenyan legal system plays an important role in determining the success of corporate governance system in the country. Nevertheless, the recent movement towards privatization of public corporations has made the country to adopt codes of corporate governance that were drafted from a combination of codes from countries which are considered to be well developed (Musikali, 2008). Financial scandals like Anglo-Leasing and Goldenberg have indicated that the country cannot effectively regulate its corporations due to inefficiencies in its legal system. Therefore, corporate governance in the country is based on codes drafted from countries with strong legal systems and corporate structures.

Corporate governance in Kenya is characterized by lack of corporate culture. Musikali (2008) emphasizes that the lack of corporate culture in the country can be attributed to the absence of national values. This has made a significant number of boards to be biased in terms of ethnic backgrounds thereby making them to be more concerned with the interests of a given community at the expense of the shareholders interest. Moreover, regulators of corporate governance in the country lack the necessary resources in order to ensure that companies efficiently comply with the law. Furthermore, the use of market mechanisms in order to enhance corporate governance has not been sufficiently adopted in the country.

2.5 Working Capital Management Efficiency

The relationship between working capital management efficiency and profitability makes working capital management to be important for firms. Efficient working capital management involves controlling and planning

of current assets and current liabilities in a way that avoids excessive or insufficient investments in short term assets (Sen at el, 2011). According to Achchuthan and Kajananthan (2013), cash conversion cycle (CCC) is taken as the most suitable measure of working capital management efficiency. Vural at el (2012) affirm that CCC is the most popular measurement of working capital management efficiency. CCC refers to the period of time during which a firm changes its money into goods and the goods to money. However, Owolabi and Small (2012) note that the use of CCC is more appropriate in measuring liquidity of a firm.

Shehzad at el (2012) observes that there are three indexes that can be used to examine working capital management efficiency. They include performance index (PI), utilization index (UI) and overall efficiency index (EI). The PI denotes the average overall performance of a firm in managing its current assets components. On the other hand, the UI indicates the capability of a company to utilize its current assets as a whole in generating income or sales. This implies that the UI measures the changes in current assets to changes in sales of a firm. Finally, the EI is a product of both the PI as well as the UI and it is used to measure the efficiency of a firm in managing its working capital. Barine (2012) observes that a more than 1.0 overall efficiency index indicates that a firm has a greater control in the management of its working capital resources.

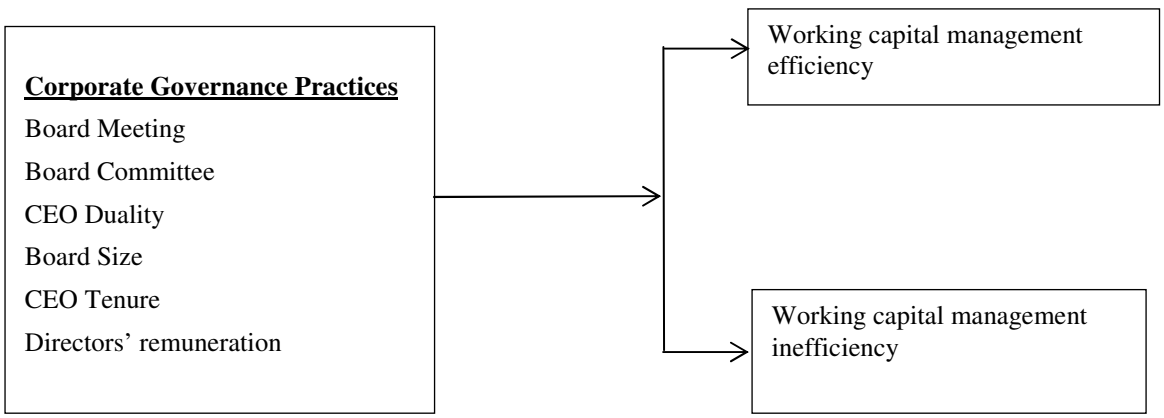
2.6 Empirical Studies

Shehzad at el (2012) conducted a study to determine the relationship between working capital management efficiency and earnings before interest and tax (EBIT) in the textile sector of Pakistan. They used three index variables 'PI', 'UI' and 'EI' to measure working capital management efficiency. The results of their study indicated that there is a positive relationship between working capital management efficiency and EBIT. Furthermore, Valipour and Jamshidi (2012) investigated the optimal efficiency of working capital management and its relationship with efficiency of assets in categorized industries in Tehran. They utilized both the CCC and EI to measure working capital management efficiency. According to their conclusions, the EI is more suitable in determining working capital management efficiency as compared to the CCC.

Gill and Biger (2013) did a study on the impact of corporate governance on working capital management efficiency of American manufacturing firms. They used CEO tenure, CEO duality, and audit committee and board size to measure corporate governance. On the other hand, accounts receivables, account payables, CCC, cash conversion efficiency and sales growth as well as current ratio were used to measure working capital management efficiency. They concluded that corporate governance improves a firm's working capital management efficiency.

According to Kajananthan and Achchuthan (2013) there is no significant relationship between corporate governance and working capital management efficiency. The results of the study indicated that board size, board leadership structure and board committee have no significant impact on working capital management efficiency. The objective of the study was to determine the impact of corporate governance practices on working capital management in Sri Lanka. The study used CEO duality, board size and number of committees as well as board meeting to measure corporate governance. On the other hand, working capital management efficiency was measured using CCC, current liabilities to total assets and current assets to total assets.

Figure 1: Conceptualization



3.0 RESEARCH METHODOLOGY

Correlational research design was adopted in this study. This is because correlational research is concerned with studying a problem in order to explain the relationship between variables. Firms that had been consistently listed at the NSE and had engaged in active trading from 2006 to 2012 were selected to constitute the sample. Forty two (42) companies had been consistently listed at the NSE from 2006-2012 and these companies formed the sample of the study.

3.1 Data Collection

Data on corporate governance and working capital management was mainly collected from the secondary sources. Annual published financial statements covering the seven year period were used for this study. Data on corporate governance consisted of board duality, board size, board meeting, board committees and CEO tenure. These variables were selected based on previous studies. On the other hand, data on working capital management efficiency included annual sales, current assets, current liabilities and size of working capital.

3.5 Data Analysis

Descriptive statistics was used to analyze the collected data. Maximum, minimum, mean and standard deviation measures relating to corporate governance practices were used so as to accomplish the first objective. In objective two, three indices; performance index of working capital management, working capital utilization index and the overall working capital management efficiency index were computed. A more than 1.0 efficiency index indicated efficient levels of working capital management. According to Bhattacharya (1997) the overall working capital management efficiency can be computed as follows;

$$WCMEI_{WCM} = PI_{WCM} * UI_{WCM}$$

The performance index of working capital management efficiency ($PI_{WCM)}$ was computed as follows;

$$P1 = \frac{Is \sum_{I=i}^{n} \frac{W_i(t-1)}{W_{it}}}{N}$$

Where I_S Sales index
S Sales
Wi Individual groups of current assets
N Number of current assets groups (five groups)
I 1,2……N

In this study current assets were divided into five individual components: short term marketable securities, cash, accounts receivables, inventory and other current assets.

The utilization index of working capital management efficiency (UI_{WCM}) was computed as follows;

$$UI\ wcm = \frac{A_{t-i}}{A_t}$$

Where A_{t-} Current assets/ Sales

In objective 3, correlation and regression analysis were used to test the relationship between the independent variable corporate governance and the dependent variable working capital management efficiency. Coefficient of determination value greater than 0.5 indicated a strong relationship between the variables. Independent one-way ANOVA and independent one tailed t-test were used to determine the level of significance of the regression co-efficient. The regression model that was employed in the study can be specified as follows;

$WCMEI_{i,t} = \alpha + \beta_1 CD + \beta_2 BS_{i,t} + \beta_3 BC_{i,t} + \beta_4 BM_{i,t} + \beta_5 CT + \beta_6 DR_{i,t} + \beta_7 FS_{i,t} + \beta_8 PF_{i,t} + \beta_9 L_{i,t} + \mu$

Whereby;

CEO duality $(CD)_{i,t}$. Assigned value 1 if the same person occupies the post of the Chairperson of the board and the CEO and 0 if otherwise for firm i in year t.

Board size (BS). Logarithm of the number of directors serving in the board for firm i in year t.

Board committees $(BC)_{i,t.}$ logarithm of the number of board committees for firm i in year t.

Board meetings $(BM)_{i,t}$. based on the number of meetings; 1- 5 were represented as 1; 6- 10 were represented as 2; 11-15 were represented as 3; 16 and above were represented as 4 for firm i in year t.

CEO tenure $(CT)_{i,t}$ logarithm of the number of years served by the CEO for firm i in period t.

Directors remuneration $(DR)_{i,t}$. logarithm of the total remuneration paid to directors for firm i in year t.

Firm Size $(FS)_{i,t}$. logarithm of average assets of firm'i' in year't'

Profitability $PF_{i,t.}$ Ratio of net income after tax divided by sales revenue for firm'i' in year't'

Leverage $(L)_{i,t}$. Ratio of debt to equity ratio for firm 'i' in year't'

α	Y-intercept
$\beta_{1-}\ \beta_{10}$	Coefficient of the explanatory variables.
μ	Error term.

In addition to the independent variables, the model included three control variables which have an effect on working capital management efficiency of firms. These were; firm size (FS), profitability (PF) and leverage (L).Variance inflation factor (VIF) was used to detect for multicollinearity among the independent variables.

4. Results and analysis

Descriptive statistics

Table 1

	Minimum	Maximum	Mean	SD
CEO Duality	0	1	0.05	0.216
Board size	3	13	8.14	2.495
Board committees	0	7	1.95	1.581
Board Meetings	2	22	6	3.968
CEO tenure	1	28	7.67	5.136
Directors remuneration	5.318	8.36	7.421	0.694
WCME	-3.494	6.231	1.060	1.654
Firm size	5.124	8.345	6.977	0.773
Profitability	-0.130	1.169	0.177	0.202
Leverage	0.000	10.990	1.941	2.991

Table 1 shows that the mean CEO duality was 0.05. This means that some companies had CEOs who also acted as the chairpersons of their boards. The average board size was 8.14 while the mean number of board committees was 1.95 with the maximum number of board committees being 7. The average number of board meetings was 6 whereas the overall mean CEO tenure was 7.421 years.

The average working capital management efficiency index was 1.060 while the minimum efficiency index was -3.494. This implies that some companies had not managed their working capital efficiently because the

efficiency index was less than 1. Profitability had a mean of 0.177 while the average firm size was 6.977 whereas leverage recorded a mean of 1.941.

Table 2: Pearson Bivariate Correlation Analysis and two tailed t-test

Correlations								
		Board Size	Board Meetings	Directors Remuneration	Board Committee	CEO Duality	CEO tenure	WCME
Board size	Pearson Correlation	1	.260	.723**	.653**	-.392*	-.049	.162
	Sig. (2-tailed)		.097	.000	.000	.010	.757	.305
Board meetings	Pearson Correlation		1	.013	.550**	-.095	-.116	-.128
	Sig. (2-tailed)			.936	.000	.549	.465	.420
Directors remuneration	Pearson Correlation			1	.619**	-.300	.106	.080
	Sig. (2-tailed)				.000	.053	.505	.613
Board committees	Pearson Correlation	.			1	-.319*	-.045	.069
	Sig. (2-tailed)					.040	.777	.665
CEO duality	Pearson Correlation					1	.147	.056
	Sig. (2-tailed)						.353	.723
CEO tenure	Pearson Correlation						1	.076
	Sig. (2-tailed)							.632
WCME	Pearson Correlation							1
	N	42	42	42	42	42	42	42
**. Correlation is significant at the 0.01 level (2-tailed).								
*. Correlation is significant at the 0.05 level (2-tailed).								

According to table 2, board size, directors' remuneration, board committees, CEO duality and CEO tenure were positively correlated with WCME. However, the relationship was not statistically significant ($p>0.05$). Furthermore, Board meetings were found to be negatively correlated with working capital management efficiency. Nonetheless, the relationship was statistically insignificant.

Table 3: Multiple Regression analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.351[a]	.123	-.123	1.7525347	.123	.500	9	32	.863	2.069

a. Predictors: (Constant), Long term leverage, CEO duality, Board meetings, CEO tenure, Profits, Directors remuneration, Board size, Board committees, Firm size
b. Dependent Variable: WCME

The correlation coefficient(R) value was 0.351 as shown in table 3. This means that there is a weak relationship between corporate governance and working capital management efficiency($r>0.5$). Furthermore, table 2 indicates that corporate governance explains only 12.3% of the differences in working capital management efficiency as

shown by the coefficient of determination value (R^2) of 0.123. The Durbin-Watson measure of autocorrelation in this analysis was 2.069. This signifies that there was no autocorrelation among the independent variables due to the fact that it was within the acceptable levels of 1.5 to 2.5.

Test of hypothesis

Table 4: ANOVA test

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	13.823	9	1.536	.500	.863[b]
	Residual	98.284	32	3.071		
	Total	112.107	41			

a. Dependent Variable: WCME

b. Predictors: (Constant), Long term leverage, CEO duality, Board meetings, CEO tenure, Profits, Directors remuneration, Board size, Board committees, Firm size

Source: Research data (2013).

According to table 4, the overall significance of the model was 0.863 with an F value of 0.5. The level of significance was higher than 0.005 and this means that corporate governance practices do not show statistically significant relationship with working capital management efficiency. Therefore this study fails to reject the null hypothesis and concludes that there is no statistical relationship between corporate governance and working capital management efficiency.

Table 5: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Collinearity Statistics	
		B	Std. Error	Beta			Lower Bound	Upper Bound	Tolerance	VIF
1	(Constant)	1.701	4.338		.392	.698	-7.135	10.536		
	Board size	4.627	3.224	.432	1.435	.161	-1.940	11.193	.302	3.306
	Directors remuneration	-.616	.738	-.258	-.835	.410	-2.120	.887	.286	3.502
	Board meetings	-.579	.470	-.298	-1.233	.227	-1.535	.378	.470	2.128
	Board committees	1.856	2.819	.216	.658	.515	-3.886	7.598	.254	3.930
	CEO tenure	.658	1.115	.105	.590	.559	-1.614	2.930	.860	1.163
	CEO duality	1.312	1.448	.171	.906	.371	-1.636	4.261	.769	1.300
	Profits	-.059	1.449	-.007	-.041	.968	-3.010	2.892	.873	1.145
	Firm size	-.099	.734	-.046	-.135	.893	-1.594	1.395	.233	4.291
	Long term leverage	-.073	.105	-.132	-.696	.492	-.287	.141	.757	1.321

a. Dependent Variable: WCME

Table 5 further shows that there is no statistical significant relationship between corporate governance practices (board size, directors remuneration, board meetings, board committees, CEO tenure and CEO duality) and working capital management efficiency ($p>0.05$).

The multi-collinearity tests indicated that none of the Variance of inflation factor was around or equal to 5. This signifies that there was no multi-collinearity between the independent variables. This is further evidenced by the fact that the tolerance values were more than 0.2.

Table 6: Independent one way ANOVA test and Independent one tailed T test

Corporate governance variables	F value	**t value**
Board Size	.334	.152
Board Meetings	3.649	.210
Directors remuneration	4.856	.307
Board committees	.914	.333
CEO Duality	.127	.362
CEO tenure	.063	.316

Table 6 shows that the computed F values in regard to the relationship between each of the corporate governance variables and working capital management efficiency were greater than 0.05. Similarly, one tailed significance values between the individual corporate governance practices and WCME were higher than the alpha value of 0.05. This signifies that corporate governance practices are statistically insignificant in explaining changes in the levels of working capital management efficiency. Therefore, these results further support the null hypothesis that there is no statistical significant relationship between corporate governance and working capital management efficiency.

5.0 Summary and Conclusions

The aim of the study was to evaluate the relationship between corporate governance and working capital management efficiency of firms listed at the NSE. The empirical results of the study indicated that there was a positive but a weak correlation between board size and working capital management efficiency. However, there was no statistical significant relationship between board size and the levels of efficiency in working capital management among firms listed at the NSE. This suggests that the size of the board has no significant impact on the levels of working capital management of a firm. Furthermore, correlation results indicated that there was a negative relationship between board meetings and the levels of efficiency in working capital management efficiency. This suggests that an increase in the number of board meetings causes companies to tie more funds in current assets thereby leading to working capital management inefficiency. Moreover, CEO tenure was found to have a weak positive relationship with the levels of working capital management efficiency. This suggests that CEOs who serve for a long term are able to moderately improve the levels of working capital management efficiency of a company.

The results from the multiple regression analysis indicated that there is a positive but a weak relationship between corporate governance and working capital management efficiency. This indicates that corporate governance contributes positively towards working capital management efficiency. However, both the ANOVA test and the individual t tests indicated that the relationship was not statistically significant. Therefore, this study concludes that there is no relationship between corporate governance and working capital management efficiency.

6.0 Recommendations for Further Study

Future studies should be conducted to determine the impact of corporate governance practices on working capital management efficiency using larger samples and longer time periods. Furthermore, future studies should include other non-listed firms.

A comparative study should be specifically undertaken using other measures of working capital management efficiency like the current ratio, inventory conversion period, cash conversion cycle, accounts payable period and accounts receivable period.

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