

Moderating Effect of Corporate Governance on the Relationship Between Inventory Conversion Period and Financial Performance of Non-Financial Firms Listed at the Nairobi Securities Exchange-Kenya

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Cite this article in APA

Onduru, R. A., Ong'eta, J. O., & Aunga, D. O. (2026). Moderating effect of corporate governance on the relationship between inventory conversion period and financial performance of non-financial firms listed at the Nairobi Securities Exchange-Kenya. *Journal of business and entrepreneurship*, 5(1), 114-123. <https://doi.org/10.51317/wenq4045>



A publication of Editon Consortium Publishing (online)

Article history

Received: 2026-08-26

Accepted: 2026-09-11

Published: 2026-10-09

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Abstract

This study examined the moderating effect of corporate governance on the relationship between inventory conversion period and financial performance of non-financial firms listed on the Nairobi Securities Exchange (NSE). The study adopted an explanatory research design and positivist research philosophy, using a longitudinal research strategy and secondary panel data covering ten years, from 2016 to 2025. A census of 32 eligible non-financial firms generated 320 firm-year observations. Financial performance was measured using Return on Assets (ROA); the inventory conversion period was measured as inventory divided by cost of sales multiplied by 365 days; and corporate governance was measured using a composite governance index. Firm size, measured as the natural logarithm of total assets, was used as a control variable. Data were analysed using descriptive statistics, Pearson correlation, and hierarchical panel regression analysis. The inventory conversion period averaged 77.442 days (SD = 15.035) and had a negative and statistically significant association with financial performance ($r = -.4670$, $p = .05$). It also had a negative and statistically significant direct effect on financial performance ($\beta = -0.0088$, $p = .000$). Corporate governance had a positive and statistically significant direct effect on financial performance ($\beta = 0.3767$, $p = .000$). The interaction between corporate governance and inventory conversion period was positive and statistically significant ($\beta = 0.0157271$, $p < .05$), indicating that corporate governance weakens the negative effect of prolonged inventory conversion periods. The study concludes that stronger corporate governance enhances oversight, accountability, and inventory management, thereby mitigating adverse financial effects.

Key terms: Corporate governance, financial performance, inventory conversion period, moderation, non-financial firms.

INTRODUCTION

This study will be premised on theories including Trade-off theory, which helps explain why firms maintain certain levels of inventory, receivables and payables to optimise performance. Working capital management encompasses all decisions pertaining to the management of current assets and liabilities, and this includes calculating the ideal quantity of cash, receivables, inventory, and current liabilities (Nastiti et al., 2019).

Corporate governance is referred to as a system of regulations and rules that guides the relationship between companies and stakeholders, and further, they guide how the company is directed and controlled. The primary function of corporate governance is to manage and control the actions of the board. The control and monitoring system entails the board of directors overseeing the management's activities with the aim of maximising shareholder value (Jebran & Chen, 2022).

Thus, the importance of corporate governance as a moderator on the relationship between working capital management and financial performance is a thought-provoking research avenue. As stated by various scholars, there is a relationship between working capital and financial performance, although the extent is unknown, including the moderating effect of corporate governance. In Kenya, research undertaken on the influence of working capital management on financial performance has yielded conflicting findings, and the role of corporate governance in modulating this link remains unclear.

Financial performance is a critical measure of the sustainability, efficiency and value-creation capacity of firms. It reflects how effectively firms utilise their resources to generate returns for shareholders and other stakeholders. Persistent deterioration or instability in these indicators may signal inefficient resource utilisation and reduced capacity to generate sustainable returns. Maintaining satisfactory financial performance is therefore a major concern for non-financial firms listed on the Nairobi Securities Exchange (NSE).

The management of the inventory conversion period (ICP) may influence the amount of capital tied up in

operations, financing requirements and, ultimately, financial performance. However, empirical findings on the relationship between working capital management and financial performance remain inconsistent, with studies reporting positive, negative and insignificant relationships. Corporate governance may provide an important explanation for these differences, as it may not only influence financial performance directly but may also strengthen or weaken the relationship between inventory management and financial performance.

Despite the growing literature on working capital management and financial performance, an empirical gap remains in Kenya. Existing studies have largely focused on the direct relationship between working capital management and financial performance, with limited attention to the moderating role of corporate governance. In particular, limited evidence exists on whether corporate governance modifies the relationship between inventory conversion period and financial performance, as measured by Return on Assets (ROA), among non-financial firms listed on the Nairobi Securities Exchange (NSE).

The objective of the study was to establish the moderating effect of corporate governance on the relationship between inventory conversion period and financial performance of non-financial firms listed on the Nairobi Securities Exchange. The study hypothesised that corporate governance does not moderate the relationship between inventory conversion period and financial performance of non-financial firms listed on the Nairobi Securities Exchange.

LITERATURE REVIEW

Theoretical Review

Trade-Off Theory

The Trade-Off Theory of capital structure was initially developed by Franco Modigliani and Merton Miller (MM) in 1958, with the "trade-off theory" as known today, incorporating factors like taxes and bankruptcy costs, later refined by them. The theory states that companies must weigh the advantages of debt financing with the disadvantages of financial distress and strive to maintain a balance between the two. The main purpose of using the trade-off theory for working capital management is to allow the firm to

determine a level of working capital that is best for it, balancing the benefits of carrying too much or too little cash, inventory, and accounts receivable, and maximising the value of the firm and its financial performance.

The idea of Trade-off Theory has been extended to other scenarios, for example, to the optimisation of a cash balance in businesses, where deterministic models of inventory control were adapted to optimise cash balance. Overall, the proponents of the Trade-off Theory have contributed significantly to the understanding of inventory management, monetary theory, and optimisation of various operational processes.

Working capital management is closely linked to this approach, as it specifically targets the efficient management of the working capital variables in order to enhance liquidity. Studies on working capital management and financial performance have shown that skilful management of working capital positively affects a company's profitability and growth (Siraj et al., 2019; Le et al., 2018).

By reducing the number of days of accounts receivable and the inventory conversion period, firms can increase profitability, indicating a negative relationship between profitability and working capital management (Le et al., 2018). Efficient working capital management, including inventory management, is crucial for enhancing a firm's profitability (Mugechi, 2020). Moreover, the inventory conversion period, a key component of working capital management, plays a vital role in maintaining a firm's liquidity, solvency, and profitability.

Furthermore, working capital management directly affects a firm's financial performance, including its liquidity, profitability, and growth (Garg & Gumbochuma, 2015).

In conclusion, the Trade-off theory as a working capital management theory has a vital role in grasping the impact of the working capital management methods on a company's financial performance. Managing working capital elements, like inventory, in an effective way can enhance the liquidity, profitability, and fiscal well-being of businesses.

Empirical Review

Inventory Conversion Period and Financial Performance

According to Abdulazeez et al. (2018), inventory management was examined at a number of small businesses in Nigeria, Kwara State. The study investigated the impact of inventory value on a performance proxy, specifically profit, over a ten-year period analysed by a regression model; according to the data, a one-naira increase in inventory resulted in an approximately 92-kobo improvement in profitability for the chosen firms. The data showed a strong positive relationship between inventory and profitability among small and medium businesses in Nigeria. As a result, it is concluded that medium businesses that deploy an effective inventory management system are more likely to generate higher revenues. However, the study was based on inventory management, but the current study will be based on the inventory turnover period.

Vartak (2018) examines the association between working capital management and the profitability of textile companies in India. Using a balanced panel dataset of 160 textile producers from 2000 to 2005, we estimated an ordinary least squares model and a fixed effects model. The analysis finds a substantial and negative association between return on assets and average days receivable, a positive correlation between return on assets and average days in inventory, and a large and negative correlation between return on assets and average days paid out. Furthermore, there is a significant positive relationship between return on assets and the cash conversion cycle, implying that a longer Cash conversion cycle (CCC) is more profitable in the textile business. This study was based on the textile business, but the current study will focus on non-financial firms listed on the Nairobi Securities Exchange, Kenya, to check on the conflicting results.

Nguyen (2018) did a study in Iran about the relationship between working capital management within the period 2001- 2006 and a sample of 1063 out of 2628 companies. Using multiple regression and Pearson's correlation, the study found a negative significant relation between the number of days accounts receivable and profitability, a negative significant relation between Inventory turnover in

days and profitability, a direct significant relation between the number of days accounts payable and profitability, and a negative significant relation between the cash conversion cycle and profitability. The study reviewed was based on a correlational research design, but the current study will focus on a mixed-methods design.

Chisti (2017) conducted an empirical investigation to examine the impact of working capital management on the financial performance of companies in an emerging market. The dataset included firms that were listed on the Cyprus Securities Exchange in Nicosia from 2000 to 2007. Our multivariate regression analysis revealed that better working capital management correlates with higher profitability. The findings indicate that the firm's profitability is linked to the cash conversion cycle and its primary aspects, including inventory turnover period, creditors' payment time and sales outstanding. However, the current study will be conducted to confirm or disapprove the findings.

Arulanandam et al. (2023) established the effects of Working Capital Management on the Profitability of Malaysia Listed Firms. Regression analysis on a panel sample of 255 businesses that were listed on the Thailand Securities Exchange between 2007 and 2009 was conducted. The results showed an adverse relationship between gross operating profits and the inventory conversion period, together with the receivables collection period. The study found that managers may increase their companies' profitability by shortening the cash conversion cycle, inventory conversion period, and receivables collection time. They are also unable to increase profitability by extending the payables period. This study reviewed businesses listed on the Thailand Securities Exchange, but the current study will focus on non-financial firms listed on the Nairobi Securities Exchange, Kenya.

Rugambwa (2016) conducted research on the impact of working capital management on profitability, focusing on the top five beer brewery companies in Tanzania. Their primary focus was working capital management, specifically the cash conversion cycle (CCC) and its various components, and how they affect the profitability of the Tanzanian beer brewing enterprises. The cross-sectional time series data were

analysed using multiple regression models. The study revealed that the profitability of beer brewery enterprises is influenced by the components of working capital management, sales growth, and a shorter period of collecting debts from customers. However, this study reviewed the top five beer brewery companies, but the current study will focus on non-financial firms listed on the Nairobi Securities Exchange, Kenya.

Research Gap

Existing research has given limited attention to the moderating role of corporate governance in the relationship between inventory conversion period and financial performance. In particular, there is limited empirical evidence on whether corporate governance strengthens or weakens the effect of inventory conversion period on financial performance. Although previous studies have examined working capital management and financial performance, limited attention has been given to the interaction between inventory conversion period and corporate governance among non-financial firms listed on the Nairobi Securities Exchange (NSE). Consequently, a contextual and empirical gap exists concerning how corporate governance moderates the relationship between inventory conversion period and financial performance in this population. The present study seeks to address this gap by examining the moderating effect of corporate governance on the relationship between inventory conversion period and financial performance of non-financial firms listed on the NSE.

METHODOLOGY

The study adopted a positivist philosophical approach. Positivism was chosen because it aligns with the study's aim of identifying objective, quantifiable relationships between variables. This approach assumes that reality is objective and can be measured independently of human perception, enabling a clear, systematic investigation into cause-and-effect relationships.

The study adopted an explanatory research design, which was appropriate for examining the relationships among inventory conversion period, corporate governance, and financial performance. The study employed a deductive approach, which involves

testing existing theoretical propositions using empirical evidence, guided by the Trade-off Theory. A longitudinal research strategy was adopted using secondary panel data covering ten years, from 2016 to 2025.

The target population consisted of non-financial firms listed on the Nairobi Securities Exchange over the financial years 2016 to 2025. Firms were included if they remained operational and continuously listed on the NSE throughout the study period, and firms with incomplete annual financial reports or those listed after 2016 were excluded. Applying these criteria resulted in 32 eligible non-financial firms, generating 320 firm-year observations across seven industries. The study relied on secondary quantitative data extracted from the annual audited financial reports of the sampled firms.

Financial performance was measured using Return on Assets (ROA), calculated as profit after tax divided by total assets, expressed as a ratio.

Inventory conversion period indicates the average number of days a firm takes to convert inventory into sales. Efficient inventory management reduces the amount of capital tied up in stock and minimises storage and obsolescence costs. Conversely, a prolonged conversion period may indicate slow-moving inventory and inefficient utilisation of resources, potentially reducing financial performance. It was measured as inventory divided by cost of sales, multiplied by 365 days.

Corporate governance was the moderating variable, measured using a composite governance index incorporating audit committee independence, board chairperson independence, and board diversity in terms of education, gender, and tenure. Each corporate governance characteristic was first measured using established criteria and then assessed against the sample median, with the scores aggregated to obtain a composite corporate governance score, where higher scores indicate stronger corporate governance.

Firm size was measured as the natural logarithm of a company's total assets at the end of the financial year and was included as a control variable because larger

firms are generally expected to have stronger monitoring systems in place and face higher levels of public and regulatory scrutiny, which can influence their financial performance.

The study relied on audited financial statements and other publicly available reports of non-financial firms listed on the Nairobi Securities Exchange. Since the information was publicly accessible, no personal or confidential data were collected. All sources were appropriately cited and referenced, and the data were accurately recorded, analysed, and reported without manipulation.

FINDINGS AND DISCUSSION

Firm Selection

The study focused on non-financial firms listed on the Nairobi Securities Exchange (NSE) and employed secondary data primarily obtained from audited annual financial statements sourced from the NSE and African Financials. An explanatory research design and positivist research philosophy, using a longitudinal research strategy and secondary panel data, were adopted, covering 32 non-financial firms that met the inclusion criteria over the ten years from 2016 to 2025, yielding 320 firm-year observations.

Descriptive Statistics

Inventory Conversion Period registered a mean of 77.442 days (SD = 15.035), bounded by a minimum of 28.566 days and a maximum of 116.023 days. This indicates that, on average, sampled non-financial firms on the Nairobi Securities Exchange required approximately 77 days (two and a half months) to hold, process, and sell their inventory assets. The relatively low standard deviation suggests that inventory conversion periods were fairly concentrated around the mean, indicating a degree of consistency in inventory holding and turnover practices across the sampled firms, although the operational spread from under one month to over three and a half months underscores structural differences in inventory control, supply chain efficiency, demand forecasting, and product perishability across the various non-financial sectors listed on the exchange. Ibrahim and Obeidat (2021) noted that a longer inventory conversion period may negatively affect financial performance, since prolonged inventory holding ties up capital and may increase holding and storage costs.

Corporate Governance registered a mean score of 0.548 (SD = 0.104), with values ranging from 0.217 to 0.803, indicating that, on average, sampled firms satisfied approximately 54.8 per cent of the key governance benchmark criteria during the observation period.

Correlation Analysis

Correlation refers to a statistical measure of the association between two variables. It indicates both the direction and strength of the relationship between the variables (Yang et al., 2023). The correlation coefficient ranges from -1 to +1, where +1 indicates a perfect positive relationship, -1 indicates a perfect negative relationship, and 0 indicates no linear relationship (Gujarati, 2015).

Inventory conversion period had a negative and statistically significant association with financial performance ($r = -.4670$, $p = .05$). This means that an increase in the inventory conversion period is associated with a decrease in financial performance among firms listed on the NSE, as prolonged inventory holding can tie up funds in stock, increase storage and holding costs, and expose firms to inventory obsolescence or deterioration. This concurs with Kouaib et al. (2024), who noted that a longer inventory conversion period diminishes return on assets.

Corporate governance had a positive and statistically significant association with financial performance ($r = .1405$, $p = .05$), suggesting that firms with stronger corporate governance mechanisms may be better positioned to strengthen accountability, oversight, and the efficiency of managerial decision-making.

Table 1: Correlation Results

	FP	FS	ARP	APP	ICP	CG
FP	1.0000					
FS	0.1404 *	1.0000				
ARP	-0.3981*	-0.0570	1.0000			
APP	0.4205 *	-0.1489 *	0.0388	1.0000		
ICP	-0.4670*	-0.0383	0.0321	-0.0244	1.0000	
CG	0.1405 *	-0.1273 *	0.0334	-0.0091	-0.1146	1.0000

Source: Data Analysis, 2026

FP: Financial Performance, FS: Firm Size, ARP: Accounts Receivable Period, APP: Accounts Payable Period, ICP: Inventory Conversion Period, CG: Corporate Governance

* Correlation is significant at the 0.05 level (2-tailed).

Direct Effects and Financial Performance

Accordingly, the study first estimated the direct effect of financial performance on the interaction term while controlling for firm size. This preliminary analysis established whether the interaction effect was statistically significant and provided the basis for proceeding with the moderation analysis.

Figure 1 below illustrates the buffering moderating effect of corporate governance on the relationship between inventory conversion period and financial performance. The findings indicate that, across all levels of corporate governance, an increase in the inventory conversion period is associated with a decline in financial performance, as reflected by the

downward slope of the three conditional lines. However, the strength of this negative relationship varies with the level of corporate governance. At lower inventory conversion periods, firms with high levels of corporate governance record higher predicted financial performance compared with firms with mean and low levels of corporate governance, suggesting a protective effect of stronger governance. As the inventory conversion period increases beyond approximately 90 days, the conditional lines gradually converge and intersect around 90–100 days. Beyond this range, the performance advantage associated with higher levels of corporate governance becomes less pronounced.

Overall, the pattern demonstrates a buffering moderating effect, whereby stronger corporate governance helps cushion the adverse effect of prolonged inventory conversion periods on financial performance. This suggests that effective governance

mechanisms can mitigate the negative performance consequences of prolonged inventory holding, although the protective effect of stronger governance may diminish when inventory conversion periods become excessively long.

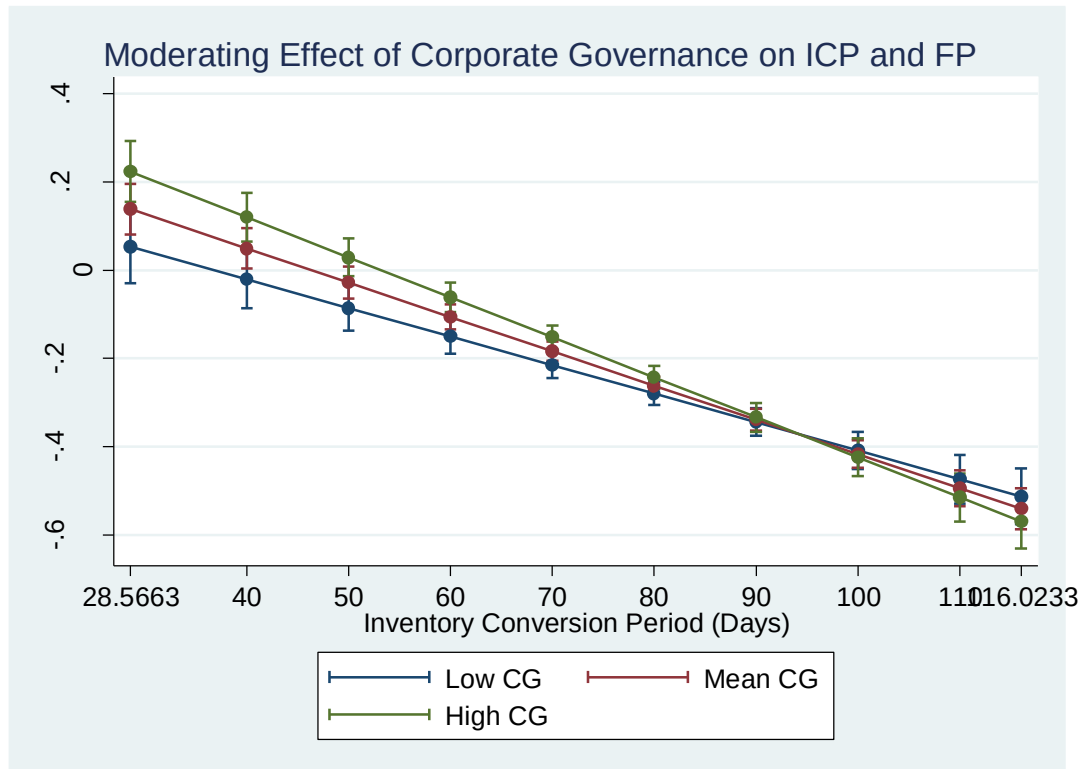


Figure 1: Mod graph on the Moderation of Corporate Governance on the Relationship Between ICP and FP

Regression Results and Hypothesis Testing

The inventory conversion period had a negative and statistically significant effect on financial performance ($\beta = -0.0088$, $p = .000 < 0.05$). This finding is further supported by the 95 per cent confidence interval of -0.0102264 to -0.007383, which excludes zero, confirming that the effect is statistically significant and consistently negative. This suggests that prolonged inventory holding periods tie up financial resources in unsold stock, increase storage and holding costs, and expose firms to risks such as obsolescence and deterioration, thereby weakening financial performance. This is consistent with Arulanandam et al.(2023), who acknowledged that shorter inventory conversion periods are associated with higher firm profitability, as reducing the time inventory remains tied up can improve the efficiency of working capital utilisation.

Corporate governance had a positive and statistically significant effect on financial performance ($\beta = 0.3767$, $p = .000 < 0.05$). The finding suggests that stronger corporate governance enhances monitoring, accountability and managerial oversight, thereby improving the efficient use of firm resources and financial outcomes.

The interaction between corporate governance and inventory conversion period was positive and statistically significant ($\beta = 0.0157271$, $p < .05$). This indicates that a one-unit increase in the interaction between corporate governance and inventory conversion period is associated with a 0.0157271-unit increase in financial performance, holding other factors constant. The p-value below 0.05 provides sufficient evidence to reject the null hypothesis, concluding that corporate governance significantly moderates the relationship between inventory

conversion period and financial performance. This implies that stronger corporate governance enhances managerial oversight, accountability, and control over inventory management, thereby reducing the extent to which prolonged inventory holding adversely affects financial performance. This finding aligns with

Agency Theory, which suggests that effective corporate governance strengthens managerial monitoring and control, reduces agency conflicts, and promotes efficient resource utilisation, thereby mitigating the adverse effects of prolonged inventory conversion periods on financial performance.

Table 2: Summary of Regression Results

Variable	β	p-value
Inventory Conversion Period (direct effect)	-0.0088	.000
Corporate Governance (direct effect)	0.3767	.000
Corporate Governance $\times$ Inventory Conversion Period	0.0157271	.009

Table 2 presents the regression results for the effect of inventory conversion period and corporate governance on financial performance. The inventory conversion period had a negative and statistically significant direct effect on financial performance ($\beta = -0.0088$, $p = .000$), indicating that firms taking longer to convert inventory into sales tend to record lower financial performance. Corporate governance had a positive and statistically significant direct effect on financial performance ($\beta = 0.3767$, $p = .000$), showing that firms with stronger governance structures tend to record higher financial performance. The interaction term between corporate governance and inventory conversion period was positive and statistically significant ($\beta = 0.0157271$, $p = .009$), confirming that corporate governance significantly moderates the relationship between inventory conversion period and financial performance. The positive coefficient indicates that stronger corporate governance weakens the negative effect of a prolonged inventory conversion period on financial performance, suggesting that firms with more effective governance mechanisms are better able to monitor and control inventory management decisions and thereby mitigate the adverse effects of extended inventory holding periods.

Discussion

The findings indicate that the Inventory Conversion Period (ICP) among non-financial firms listed on the Nairobi Securities Exchange (NSE) averaged 77.442 days, with a standard deviation of 15.035 days, indicating that, on average, the sampled non-financial firms required approximately 77 days to convert inventory into sales. The relatively low standard

deviation suggests that inventory conversion periods were fairly concentrated around the mean, indicating a degree of consistency in inventory holding and turnover practices across the sampled firms. Nevertheless, the minimum ICP of 28.566 days shows that some firms converted inventory into sales in less than one month, whereas the maximum of 116.023 days indicates that others required almost four months. The 87.457-day range therefore points to meaningful differences in the efficiency with which firms managed and converted inventory into sales across the study period.

The observed variation in ICP is economically important because inventory represents capital committed to the operating cycle until it is converted into sales. A shorter conversion period may enhance liquidity by releasing funds tied up in inventory and reducing inventory holding and associated costs. Conversely, a prolonged conversion period may constrain liquidity by locking financial resources in unsold inventory and increasing exposure to storage, deterioration, and obsolescence costs. Consequently, the extent to which firms manage the duration of inventory conversion can have implications for their ability to utilise working capital efficiently and sustain financial performance. This perspective is consistent with Chasha et al. (2022), who argue that a firm's liquidity position is closely influenced by the period required to convert inventory into sales, underscoring the importance of effective inventory management in maintaining liquidity.

The interaction between inventory conversion period and corporate governance has a positive and

statistically significant effect on financial performance ($\beta = 0.0157$, $p < 0.05$). This indicates that a one-unit increase in the interaction term is associated with a 0.0157-unit increase in financial performance. The finding suggests that stronger corporate governance enables firms to manage inventory holding periods more effectively through enhanced monitoring and accountability. This finding aligns with Agency Theory, which emphasises the role of corporate governance in monitoring managers and reducing conflicts of interest. Effective governance encourages efficient use of resources and helps managers maintain optimal inventory levels, thereby reducing unnecessary holding costs and improving financial performance.

CONCLUSION AND RECOMMENDATIONS

Conclusion: The study examined the moderating effect of corporate governance on the relationship between inventory conversion period and financial performance. The findings revealed that the interaction between inventory conversion period and

corporate governance was positive and statistically significant. This indicates that corporate governance positively moderates the relationship, weakening the negative effect of prolonged inventory conversion periods on financial performance. The finding concurs with Affes and Jarboui (2023), who noted that stronger corporate governance enhances monitoring and accountability in inventory management, enabling firms to better control inventory-related costs and improve the efficient utilisation of resources.

Recommendations: Firms should strengthen corporate governance structures, particularly managerial oversight and accountability mechanisms over inventory decisions, since stronger governance has been shown to weaken the adverse effect of prolonged inventory holding periods on financial performance. Boards should encourage managers to align inventory management practices with the firm's financial interests and discourage inefficient accumulation of inventory.

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