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Internally Financed Working Capital: Top Manager Preferences from the Perspective of Gender

Sunardi [1*], Theresia Woro Damayanti [2], Supramono [2]

[1] *Universitas Merdeka Malang, Malang, East Java, Indonesia*
[2] *Universitas Kristen Satya Wacana, Salatiga, Central Java, Indonesia*

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A B S T R A C T

This study seeks to investigate the differences in firm managers' preferences in the use of internal funding to meet working capital needs. The data to be analyzed are obtained from the results of the World Bank's Productivity and the Investment Climate Survey on firm managers in 98 developing countries, with a total sample of 1,235 firm managers. The analysis techniques used are linear regression and ordinal logit analysis. This study demonstrates the gender-based differences in the proportion of the use of internal funding sources. Female top managers prefer to use internal funding sources for working capital better than top male managers. This study not only provides a better understanding of the relationship between the existence of top female managers and the preference in the use of internally financed working capital but also informs firms that aim to balance the liquidity and the capital cost efficiency in managing their working capital to provide a more significant opportunity for women to occupy top management positions.

A B S T R A K

Studi ini bertujuan untuk menyelidiki perbedaan preferensi manajer perusahaan berkenaan dengan penggunaan pendanaan internal untuk pemenuhan kebutuhan modal kerja. Data untuk kepentingan analisis diperoleh hasil World Bank's Productivity and the Investment Climate Survey terhadap manajer perusahaan di 98 negara berkembangan. Adapun jumlah sampel yang digunakan adalah sebanyak 1.235 manajer perusahaan. Data dianalisis menggunanakan regresi liner dan ordinal logit analisis. Hasil studi ini menunjukkan bahwa terdapat perbedaan proporsi penggunaan pendanaan internal berdasarkan gender. Top manajer puncak perempuan memiliki prefensi untuk memilih proporsi pendanaan internal untuk modal kerja lebih tinggi dibandingkan top manajer laki-laki. Studi ini bukan hanya dapat memberikan pemahaman yang lebih baik tentang keterkaitan antara keberadaan manajer puncak perempuan dengan preferensi penggunaan sumber pendanaan internal untuk kepentingan modal kerja tetapi juga memiliki implikasi praktis bagi perusahaan bahwa jika perusahan ingin mendapatkan keseimbangan antara likuditas dan efisiensi dalam pengelolaan modal kerja maka dapat memberikan peluang yang lebih besar kepada perempuan untuk menempati posisi managemen puncak.

1. INTRODUCTION

Working capital management determines the levels of firms' current assets and liabilities. These policies are equally important to other financial policies such as financing, investment, and dividend policies. Furthermore, working capital policies involve not only firms' internal stakeholders but also external ones such as customers and suppliers. Effective working capital policies are crucial because of their role in ensuring firms' daily operating activities (Adamu & Hussaini, 2015; Marobhe, 2015) and their long-term viability (Rasyid et al., 2018). Thus, inappropriate working capital policies will likely lead to business failure (Smith, 1973).

There are two orientations of working capital policies: aggressive and conservative (Brigham & Houston, 2012). The selection of policy orientations is complicated because it involves a trade-off between liquidity and efficiency concerns. A working capital policy is said to be optimal if there

* *Corresponding author, email address: nardisu92@yahoo.com*

is a balance between risk and efficiency. However, especially in developed countries, firms prioritize liquidity risk aversion in their working capital policies. For example, a report from Ernst and Young inform that in 2018 about 1,500 leading US and European firms had excessive working capital of US $ 2.5 trillion above the required amounts for their business operations and operating cash. This figure is significant because it was equal to almost 10% of these firms' sales.

The choice of working capital policy is closely related to managers' characteristics as decision-makers, including gender. The main reason for this argument is that women tend to behave differently than men in making strategic analyses and decisions (Bear et al., 2010; Alonso-Almeida & Bremser, 2015). Thus, gender is likely associated with working capital management.

Numerous studies have investigated gender-based financial policy choices. For example, several studies have analyzed investment decisions (Bogan & Just, 2013; Levi et al., 2014; Liang at al., 2018; Lutfi, 2011; Palupi & Santoso, 2017), financing decisions (Huang & Kisgen, 2013; Faccio et al., 2016), and dividend decisions (Al-amarneh et al., 2017). In general, these studies find that top female managers tend to make less risky financing and investment decisions than top male managers. In a similar vein, top female managers exhibit higher dividend payout than firms led by top male managers because dividends are considered less risky than capital gain. However, to our best knowledge, gender-based working capital policy choices are still relatively understudied. For example, Nastiti et al. (2019) empirically find that female managers of Indonesian manufacturing firms tend to make conservative working capital policies. In this respect, top female managers tend to prefer their firms to have a higher proportion of their assets in current assets to minimize liquidity risk. However, it is likely that firms also focus on efficiency when they put greater reliance on internal sources to finance their working capital needs, because internal financing sources, especially from retained earnings, have the lowest cost of capital than other financing sources. Nastiti et al. (2019) do not investigate further the role of gender in the selection of internal financing sources for working capital management.

This study seeks to investigate gender-based preference differences in the use of internal financing sources for working capital. This study also responds to Kilic & Kuzey (2016) call for further research on the effect of women representation in top management because this issue is relatively understudied. Besides, from a practical point of view, this study illustrates the economic benefits of women representation in top management to ensure the sustainability of the firm.

2. THEORETICAL FRAMEWORK AND HYPOTHESES

Pecking Order Theory

As proposed by Myres & Majluf (1984), the pecking order theory is based on Donaldson's hypothesis in 1961 as one of the most well-known theories on firms' capital structure. The theory illustrates the order of firms' financing source choices. Managers prefer internal financing to external financing. If internal financing is insufficient, they prefer to using safer debts to risky debts. Moreover, finally, if debt financing is insufficient, stock issuance is the last alternative of financing sources. Two underlying rationalities explain the order of financing source preference, namely (1) the presence of transaction costs of external financing and (2) information asymmetry (Vasiliou et al., 2009). Internal financing does not incur transaction costs, while debt-based external financing is less costly than stock issuance. Further, information asymmetry between firms and potential investors implies that investors tend to buy discounted stocks from firms, causing new stocks as a financing source to become costly.

Several studies have provided different empirical evidence on the pecking order theory. Starting from Shyam-Sunder & Myers (1999), who empirically support pecking order theory, with follow-up studies in different contexts, also find similar results (Hsu at al., 2013; Febriana & Yulianto, 2017; Jarallah et al., 2019). However, Frank & Goyal (2009), Culata & Gunarsih (2012), and Nguyen et al. (2019) do not support pecking order theory. Despite inconclusive findings on the order of financing preferences, the pecking order theory is likely relevant in explaining working capital management.

Working Capital Policies and Gender

Both aggressive and conservative working capital policies will create a trade-off between liquidity and efficiency. For example, firms that opt for conservative current assets investment decisions will reduce liquidity risk while also their operational efficiency because they incur higher opportunity cost and cost of capital that will negatively affect their profits. Similarly, conservative financing policies motivate firms to rely more on long-term debts with relatively higher capital costs than short-term debts. According to the pecking order theory, firms should be able to mitigate the trade-off

between liquidity and efficiency. More specifically, firms can have higher internally financed working capital that leads to lower cost of capital. Thus, on the one hand, they can reduce liquidity risk or inability to fulfill short-term liabilities. On the other hand, they can avoid inefficient operation due to higher working capital investment that negatively affects firms' overall financial performance.

The choice of internal financing to meet working capital needs is likely related to the gender of the firms' decision-makers. Several studies find that female managers' presence causes firms to exhibit better corporate governance, such as more extensive public disclosure and greater willingness to join oversight committees (Adams & Ferreira, 2009; Vähämaa, 2017; DeBoskey et al., 2018). Thus, it is understandable that Kang et al. (2010) find investors' positive reactions to female directors' appointments. Based on these findings, female managers' presence is likely to reduce information asymmetry that firms will manage to acquire external financing at relatively lower costs. Thus, firms with female managers will be motivated to increase the proportion of external financing for their working capital needs.

However, it is also likely that female managers use a higher proportion of internal financing sources because of two arguments. *First,* closely related to risk preference, numerous studies show that female managers are more likely to avoid risks than male managers (Adams & Funk, 2012; Faccio et al., 2016; Yu et al., 2017). Internal financing is both less costly and less risky for firms. Meanwhile, external financing (including debts) likely causes firms to incur interest costs and face liquidity risk that will potentially lead to bankruptcy. Consequently, female managers who tend to avoid risks will seek to prioritize internal financing. *Second,* several studies demonstrate that women are less likely to exhibit overconfidence than men (e.g., Barber & Odean, 2001; Huang & Kisgen, 2013). Female managers who are less confident tend to underestimate their own abilities and overestimate risks and uncertainty (Odean, 1998; Pompian, 2012; Dittrich et al., 2014). Consequently, they are likely to finance their firms' operations or fulfill their firms' working capital requirements by prioritizing internal financing.

Based on the arguments above, the hypothesis proposed is as follows:

H_1: Female top managers will choose a higher proportion of internally financed working capital than top male managers.

3. RESEARCH METHOD

This study used the World Bank's Productivity and the Investment Climate Survey on firm managers in 98 developing countries in 2006-2018. Considering the consistency of the answers and the completeness of the data for analysis, 1,235 companies were then selected as the final sample.

Table 1. Variable Measurement.

Variable	Measurement
Top manager's gender	A dummy variable equals 1 if the top manager is female, 0 otherwise
Top manager's experience	Top manager's years of working experience in the same industry with the industry in which her/ his current firm operates
Firm age	Firm's age in 2018
Firm size	A categorical variable (4 categories): 1 if the firm is a micro firm with less than five employees, 2 if the firm is a small firm with 6-19 employees, 3 if the firm is a medium-firm with 20-99 employees, and 4 if the firm is a large firm with more than 100 employees.
Industry type	Classified into three measures, namely 1 if the firm belongs to the manufacturing industry, 2 if the firm belongs to the retail industry, and 3 if the firm belongs to the service industry.
Debt	A dummy variable equals 1 if the firm has debts from banks, 0 otherwise.

The dependent variable of this study was internal financing measured by using the question in the survey on "the proportion of working capital financed by the internal fund (%)." Meanwhile, the independent variable was the top manager's gender that was measured with the dummy variable. Because financing decisions are affected by numerous factors, the following factors were included as the control variables: manager's experience, firm's age, firm's size, industry type, and

firm's debt.

Consistent with our research objective, this study used the following regression equation:

$$IFWC_{it} = a+b_1GEN_{it} + b_2EXP_{it} + b_3SIZE_{it} + b_4AGE_{it} + b_5IND_{it} + b_6DEBT_{it} + e_{it} \quad (1)$$

Where IFWC is Internally financed working capital, GEN is Top manager's gender, EXP is Top manager's experience, SIZE is Firm's size, AGE is Firm's age, DEBT is Debt, and IND is Industry type.

4. DATA ANALYSIS AND DISCUSSION

Descriptive Statistics

Panel A of Table 2 shows that the proportion of internally financed working capital is 55.19 percent. AGE varies quite widely since some firms are newly operated, but a firm has operated for 114 years. The average firm's age is 25.97 years. On average, managers work in the same industry for 22.18 years, although the maximum value of this variable is 64 years. Crosstab is used to provide more detailed information on the categorical variables.

Table 2. Descriptive Statistics

Panel A. Descriptive Anal				
	Minimum	**Maximum**	**Mean**	**Std. Dev.**
Working Capital internal	0.00	100.00	55.19	28.41
Firm age	6.00	114.00	25.97	15.94
Experience	0.00	64.00	22.18	11.79
Panel B. Crosstab				
	Low internally financed WC	**Moderate internally financed WC**	**High internally financed WC**	**Total**
Top Manager's Gender				
Female	9 (7.69)	20 (17.09)	88 (75.21)	117.00
Male	306 (27.37)	412 (36.85)	400 (35.78)	1.118.00
Firm Size				
Small	147 (25.83)	198 (34.80)	224 (39.37)	569.00
Medium	109 (23.96)	150 (32.97)	196 (43.08)	455.00
Large	59 (27.96)	84 (39.81)	68 (32.23)	211.00
Industry				
Manufacturing	73 (21.10)	128 (36.99)	145 (41.92)	346.00
Retail	154 (25.62)	217 (36.11)	230 (38.27)	601.00
Service	88 (30.56)	87 (30.21)	113 (39.24)	288.00
Having Debts from Banks?				
No	120 (20.76)	176 (30.45)	282 (48.79)	578.00
Yes	195 (29.68)	256 (38.96)	206 (31.35)	657.00

Panel B Tabel 2 illustrates that, based on gender, there are fewer female top managers than male managers. Further, most female managers choose to use a higher proportion of internally financed working capital. However, only 35.78 percent of male managers choose a higher proportion of internally financed working capital. In this respect, 36.85 percent of male managers choose a moderate (low) proportion of internally financed working capital.

Regarding firm size, small and medium firms dominate and tend to use greater internally financed working capital (39.37 percent and 43.77 percent). In comparison, large firms tend to rely on moderate, internally financed working capital (39.81 percent).

From the industry type, firms in manufacturing, retail, and service industries tend to use high internally financed working capital. On the other side, firms that do not have debts from banks tend to use high internally financed working capital (48.90 percent). In comparison, firms with debts from banks tend to use moderate internal financing for their working capital requirements (38.96 percent). Next, the correlation matrix describes the relationship between all research variables.

Table 3. Correlation Matrix

		(1)	(2)	(3)	(4)	(5)	(6)	(7)
WC_internal (1)	Pearson Correlation	1	0.3212	-0.0774**	-0.0314	-0.0023	-0.0180	-0.1749
	Sig. (2-tailed)		0.0000**	0.0061**	0.2840	0.9333	0.5333	0.0000**
Gender (2)	Pearson Correlation		1	-0.0679	-0.0901	-0.0433	-0.0600	-0.0683
	Sig. (2-tailed)			0.0172*	0.0020**	0.1348	0.0361*	0.0171*
Industry (3)	Pearson Correlation			1	-0.0089	0.0421	0.0080	0.0060
	Sig. (2-tailed)				0.7550	0.1441	0.7731	0.8200
Firm Size (4)	Pearson Correlation				1	0.2443	0.1277	0.2383
	Sig. (2-tailed)					0.0000**	0.0000**	0.0000**
Firm Age (5)	Pearson Correlation					1	0.4461	0.2532
	Sig. (2-tailed)						0.0000**	0.0000**
Experience (6)	Pearson Correlation						1	0.2200
	Sig. (2-tailed)							0.0000**
Debt (7)	Pearson Correlation							1
	Sig. (2-tailed)							

Notes: ** correlation is significant at the 0.01 level (two-tailed) and * correlation is significant at the 0.05 level (two-tailed)

Table 3 indicates the correlation between gender and internally financed working capital. For the control variables, only industry type and bank debt are correlated with internally financed working capital. In contrast, other control variables, such as firm age, firm size, and manager's experience, are not correlated with internally financed working capital.

Hypothesis Testing

Table 4 shows the adjusted R2 value of 0.1290, that suggests that the independent variable explains 12.9% of the change of internally financed working capital. The significance value of the F-test of 0.0000 implies that the research model is acceptable. Specifically, the manager's gender, firm size, firm age, manager's experience, industry type, and debt simultaneously affect internally financed working capital.

Partially, Table 4 above demonstrates that the manager's gender significantly affects internally financed working capital (b= 0.3111; a=0.0000). Thus, top female managers will choose a higher proportion of internally financed working capital, implying that H1 is supported. The results support the arguments of Adams & Funk (2012), Faccio et al., (2016) and Yu et al., (2017) that women tend to avoid risks and female managers choose internal financing that is not only less costly but also less risky for firms than external financing. Besides, these findings also confirm the results of research from Barber & Odean (2001) and Huang & Kisgen (2013) that women are less confident than men, so those female managers will prioritize internal financing sources to meet their firms' working capital requirements.

Table 4. Regression Results

	Coefficient	t	Sig.
Gender	0.3111	11.5998	0.0000
Size	0.0259	0.9150	0.3600
Age	0.0431	1.4151	0.1570
Experience	0.0171	0.5662	0.5721
Industry	-0.0568	-2.1367	0.0333
Debt	-0.1741	-6.1771	0.0000
R	Adjusted R^2	F	Sig
0.3651	0.1290	31.5200	0.0000

The control variables' tests indicate that industry type and bank debt have a significant impact on internally financed working capital. In contrast, firm size, firm age, and manager's experience do not affect internally financed working capital.

Ordinal logit test is used to ensure the robustness of the findings. More specifically, the dependent variable is classified into three categories, namely low internally financed working capital, moderate internally financed working capital, and high internally financed working capital.

Tabel 5. Ordinal Logit Test

Effect	**Model Fitting Criteria**	**Likelihood Ratio Tests**		
	-2 Log Likelihood of Reduced Model	**Chi-Square**	**Df**	**Sig.**
Intercept	2143.4080	0.0000	0	
Gender	2211.6080	68.2000	2	0.0000
Industri	2151.3360	7.9280	4	0.0940
Size	2155.3200	11.9120	4	0.0180
Age	2324.3080	180.9000	164	0.1740
Experience	2281.9590	13.5510	116	0.0750
Debt	2183.0020	39.5950	2	0.0000
Pseudo R-square;		**Chi-Square**	**Df**	**Sig.**
Cox and Snell	0.3050			
Nagelkerke	0.3450	449.4180	292	0.0000
McFadden	0.1680			

The results of the ordinal logit test in Table 5 show that the pseudo-R2 Cox and Snell = 0.3050 suggest that the proportion of variance for internally financed working capital explained by the predictor variable is 30.5%. Meanwhile, $\chi 2 = 68.2000$ with $\alpha = 0.0000$. Thus, supporting the previous arguments gives the reason that top female managers will choose a greater proportion of internally financed working capital.

5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

This study tests the role of top managers' gender in relying on internal financing sources for working capital requirements by analyzing 1.235 firm managers in 98 developing countries from the World Bank's Productivity and the Investment Climate Survey. Based on the cross-country data, this study demonstrates a gender-based difference in the proportion of the use of internal financing sources. In particular, top female managers tend to

choose a higher proportion of internally financed working capital than top male managers.

Our results offer both academic and practical contributions. Specifically, this study provides a better understanding of the association between top female managers and the preferred order of financing sources, especially for the working capital purpose, which is relatively understudied. The findings also confirm the pecking order theory proposed by Myers & Majluf (1984) and the arguments that female managers tend to be risk-averse (Adams & Funk. 2012; Yu et al. 2017) and less confident (Barber & Odean, 2001; Huang & Kisgen. 2013). From a practical point of view, this study suggests that companies in developing countries seek to balance liquidity and capital cost efficiency in working capital management to provide more significant opportunities for women to occupy top managerial positions.

The sample used in this study is potentially biased because there is no identification of whether firm managers are also firm owners. However, the interaction between the manager's gender and firm ownership status may also result in different preferences in the order of the use of financing sources. It is recommended that future studies tackle this issue.

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