



Working Capital Efficiency and Financial Performance of Micro, Small and Medium Enterprises (MSMEs)

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Abstract

Micro, Small, and Medium Enterprises (MSMEs) play a critical role in economic development through their contribution to employment generation, innovation, income creation, and industrial growth. However, limited access to external finance and persistent liquidity challenges make effective working capital management essential for their survival and long-term success. This study examines the relationship between working capital efficiency and the financial performance of MSMEs through a systematic conceptual review of the literature. Drawing on the Resource-Based View (RBV) and Liquidity-Profitability Trade-off Theory, the study synthesises evidence from seminal and contemporary research on key dimensions of working capital management, including cash management, inventory management, accounts receivable management, accounts payable management, and cash conversion cycle efficiency.

The review adopts a PRISMA-based literature selection process and analyses empirical and conceptual studies published between 2003 and 2026. The findings consistently indicate that efficient working capital management enhances profitability, liquidity, operational efficiency, business growth, and long-term sustainability. In particular, a shorter cash conversion cycle, effective receivables collection, and optimal inventory management are found to positively influence financial performance. The review further suggests that working capital efficiency functions as a strategic organisational capability that strengthens

financial resilience and competitive advantage, especially within resource-constrained MSME environments.

Based on the synthesis of existing evidence, the study develops a conceptual framework and research propositions linking working capital efficiency to MSME financial performance. The study contributes to the literature by providing an integrated understanding of these relationships and offers managerial and policy recommendations for improving MSME competitiveness and sustainability. Future research is encouraged to empirically validate the proposed framework across diverse industrial and geographical contexts.

Keywords: Working Capital Efficiency; Working Capital Management; MSMEs; Financial Performance; Liquidity; Profitability; Cash Conversion Cycle; Sustainability; Resource-Based View.

Introduction

Micro, Small and Medium Enterprises (MSMEs) play a vital role in the economic development of both developed and developing countries. They contribute significantly to employment generation, income creation, poverty reduction, regional development, innovation, and entrepreneurship. MSMEs form the backbone of most economies because they account for a



substantial proportion of business establishments and provide livelihood opportunities to millions of people. In emerging economies, particularly in Asia and Africa, MSMEs serve as an important vehicle for inclusive growth by supporting local production, enhancing market competition, and encouraging self-employment opportunities.

Despite their significant economic contribution, MSMEs frequently encounter financial challenges that hinder their growth and sustainability. One of the most critical challenges is inefficient working capital management. Working capital refers to the funds invested in current assets such as cash, inventories, accounts receivable, and short-term investments, less current liabilities. Effective working capital management ensures that a firm maintains an optimal balance between liquidity and profitability. Insufficient working capital may result in operational disruptions, delayed supplier payments, and lost business opportunities, whereas excessive working capital can lead to inefficient utilization of resources and reduced returns.

For MSMEs, working capital efficiency is particularly important because of their limited access to external financing, dependence on short-term credit, and vulnerability to market fluctuations. Efficient management of inventory, cash, and receivables enables MSMEs to meet their day-to-day operational requirements while maintaining financial stability. Moreover, firms with effective working capital practices often experience improved profitability, higher asset turnover, stronger liquidity positions, and enhanced business sustainability.

Working Capital Component	Description	Indicator	Expected Impact on Financial Performance
Cash Management	Management of cash inflows and outflows	Cash Ratio	Improves liquidity and operational continuity
Inventory Management	Control of stock levels and inventory turnover	Inventory Turnover Ratio	Reduces holding costs and improves profitability
Accounts Receivable Management	Collection of credit sales from customers	Average Collection Period	Enhances cash flow and reduces bad debts
Accounts Payable Management	Management of payments to suppliers	Average Payment Period	Improves liquidity and supplier relationships
Cash Conversion Cycle	Time taken to convert investment into cash	CCC (Days)	Shorter cycle increases efficiency and profitability

Table 1. Components of Working Capital Efficiency and Expected Impact on Financial Performance

The relationship between working capital efficiency and financial performance has attracted considerable attention among researchers and financial practitioners. Previous studies suggest that firms that effectively manage their cash conversion cycle, inventory turnover, and accounts receivable collection periods tend to outperform firms with poor working capital practices. In the context of MSMEs, efficient working capital management not only improves profitability but also strengthens resilience against economic uncertainties and financial shocks.

Independent Variable	Dependent Variable	Expected Relationship	Theoretical Justification
Working Capital Efficiency	Profitability	Positive	Efficient utilization of current assets increases earnings
Working Capital Efficiency	Liquidity	Positive	Better management ensures availability of cash resources
Working Capital Efficiency	Asset Growth	Positive	Efficient operations support reinvestment and expansion
Working Capital Efficiency	Business Sustainability	Positive	Strong liquidity improves long-term survival
Working Capital Efficiency	Operational Performance	Positive	Faster working capital turnover improves efficiency

Table 2. Relationship between Working Capital Efficiency and Financial Performance



The present study investigates the relationship between working capital efficiency and financial performance of MSMEs. It seeks to understand how efficient management of current assets and current liabilities contributes to profitability, growth, liquidity, and long-term sustainability. By examining this relationship, the study provides valuable insights for MSME owners, financial managers, policymakers, and stakeholders seeking to improve enterprise performance through better financial management practices.

Literature Review

Working capital management (WCM) represents the administration of current assets and current liabilities to ensure operational continuity, liquidity, and profitability. It is regarded as one of the most important aspects of financial management because it directly influences a firm's ability to meet short-term obligations while maintaining profitability. Efficient working capital management enables organisations to optimise cash flows, minimise financing costs, and improve overall financial performance. Research over the past three decades has consistently demonstrated that the management of inventories, accounts receivable, accounts payable, and the cash conversion cycle significantly affects organisational profitability and value creation. turn3search7

One of the earliest influential studies in this field was conducted by Deloof (2003), who examined Belgian firms and found that managers could increase profitability by reducing the number of days accounts receivable and inventories remained outstanding. The study demonstrated a significant relationship between working capital management and corporate profitability, thereby establishing a foundation for subsequent research on working capital efficiency. turn3search6

Similarly, Lazaridis and Tryfonidis (2006) investigated 131 companies listed on the Athens Stock Exchange and found a statistically significant relationship between profitability and the cash conversion cycle. Their findings suggested that firms could create shareholder value by optimising inventory levels, receivable collection periods, and payable management. The study highlighted the importance of maintaining an optimal working capital cycle for improving profitability. turn3search12

The relationship between working capital management and profitability has also been examined extensively in the context of small and medium-sized enterprises (SMEs). García-Teruel and Martínez-Solano (2007) analysed 8,872 Spanish SMEs and found that reducing inventory holding periods, accelerating receivable collections, and shortening the cash conversion cycle significantly improved profitability. Their study was among the first to provide robust evidence regarding the importance of working capital management in SME performance. turn3search5

Further evidence from emerging economies has reinforced these conclusions. Padachi (200) argued that working capital acts as the lifeblood of business operations and that inadequate working capital management may result in liquidity problems and poor organisational performance. The study of Mauritian manufacturing firms demonstrated the importance of maintaining adequate working capital levels to support operational efficiency and profitability. turn3search14

Building on these findings, Afrifa and Padachi (2016) examined the relationship between working capital levels and SME profitability using a sample of 160 SMEs. Their results revealed a concave relationship between working capital and profitability, suggesting the existence of an optimal working capital level. Both excessive and insufficient working capital were found to adversely affect profitability. This work introduced the argument that the objective of firms should not merely be to minimise working capital but to optimise it. turn3search17

Research has also shown that the cash conversion cycle (CCC) is one of the most widely accepted indicators of working capital efficiency. The CCC measures the time required for cash invested in operations to return to the firm through sales and collections. A shorter cash conversion cycle generally indicates greater efficiency and improved firm performance. Empirical studies across developed and developing economies have consistently reported a negative relationship between CCC and profitability, indicating that firms can improve performance through efficient working capital management. turn3search7

Recent evidence continues to support these conclusions. A meta-study on working capital management and profitability concluded that efficient working capital management significantly influences firm profitability and reduces operational risk.



The review highlighted the importance of balancing liquidity and profitability objectives in financial decision-making. turn3search3

Within the MSME sector, working capital management becomes even more critical due to limited access to external financing and greater dependence on internally generated funds. MSMEs frequently experience liquidity constraints, delayed customer payments, and inventory management challenges, all of which directly influence performance. Efficient management of working capital allows MSMEs to sustain operations, improve profitability, and enhance financial resilience. turn3search17

The attached source study by Rosyadah et al. (2022) further contributes to this literature by examining MSMEs in Indonesia. The study reported a significant positive relationship between working capital and financial performance, as well as between working capital and business sustainability. These findings suggest that MSMEs with stronger working capital positions are more capable of achieving growth, profitability, and long-term sustainability. The study also emphasised that working capital effectiveness remains a crucial determinant of organisational success in emerging economies.

Research Gap

Although numerous studies have examined the relationship between working capital management and firm performance, there remains a lack of comprehensive conceptual literature that systematically explains the mechanisms through which working capital efficiency influences the financial performance of MSMEs. Furthermore, existing research provides limited theoretical integration of working capital dimensions and their role in enhancing profitability, liquidity, growth, and sustainability in MSMEs.

Research Objectives

1. To critically review and synthesise the existing literature on working capital efficiency and financial performance of MSMEs.
2. To examine the theoretical linkages between the components of working capital efficiency (cash management, inventory management, accounts receivable, and accounts payable) and financial performance indicators of MSMEs.
3. To develop a conceptual framework explaining how working capital efficiency contributes to profitability, liquidity, growth, and sustainability of MSMEs.

Conceptual Framework

The conceptual framework of this study proposes that **working capital efficiency** is a significant determinant of the **financial performance of MSMEs**. Working capital efficiency encompasses key components such as cash management, inventory management, accounts receivable management, accounts payable management, and cash conversion cycle efficiency. Efficient management of these components enables firms to maintain adequate liquidity, reduce financing costs, optimise resource utilisation, and improve operational efficiency (Deloof, 2003; Lazaridis & Tryfonidis, 2006; Padachi, 2006). Furthermore, prior studies suggest that firms with effective working capital practices achieve superior profitability and financial stability due to improved cash flows and lower operational risks (Shin & Soenen, 1998; García-Teruel & Martínez-Solano, 2007). Within the MSME context, where access to external finance is often limited, efficient working capital management becomes an essential driver of financial success and business competitiveness (Afrifa & Padachi, 2016; Rosyadah et al., 2022). Therefore, the framework assumes a direct positive relationship between working capital efficiency and the financial performance of MSMEs.

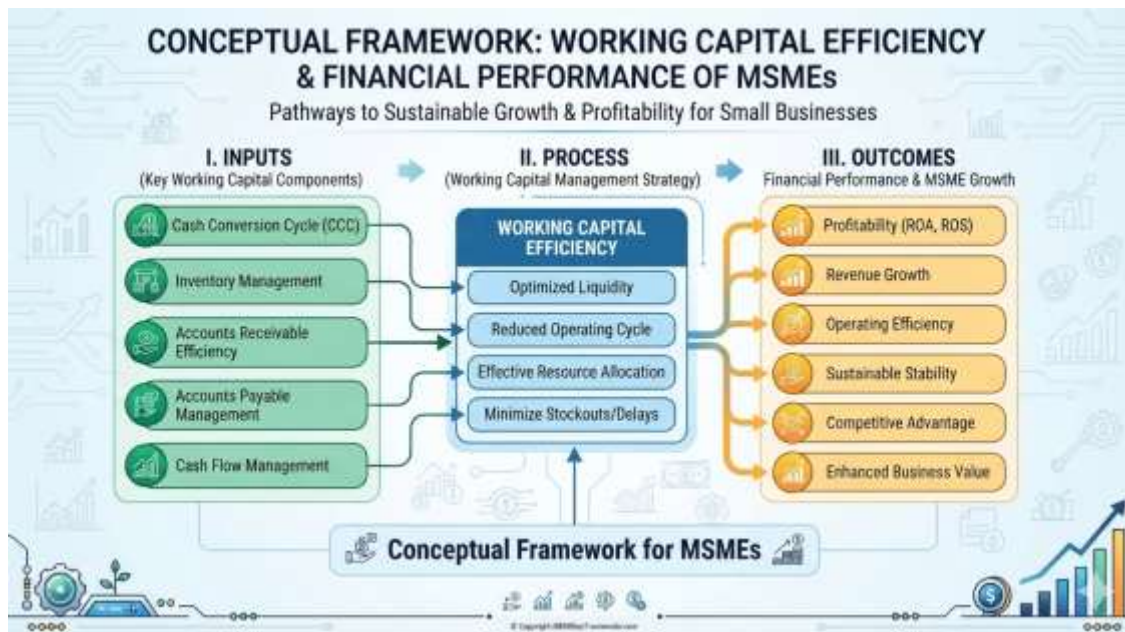


Figure 1. Conceptual Framework of Working Capital Efficiency and Financial Performance of MSMEs

This conceptual framework demonstrates how **working capital efficiency** directly drives **MSME financial performance** through an Input-Process-Outcome model. Efficiently managing inputs—like inventory, receivables, and the cash conversion cycle—feeds into strategic core processes that optimize liquidity and reduce operating cycles. Consequently, this operational speed minimizes trapped cash and self-generates organic capital. This streamlined workflow leads to superior financial outcomes, including maximized profitability (ROA/ROS), accelerated revenue growth, and long-term competitive advantage, allowing small businesses to achieve sustainable growth without relying on expensive external debt.

Methodology

This study adopts a **systematic conceptual review methodology** to examine the relationship between working capital efficiency and the financial performance of Micro, Small, and Medium Enterprises (MSMEs). A systematic review approach is particularly suitable for synthesising fragmented knowledge, identifying theoretical linkages, and developing a comprehensive conceptual framework for future empirical investigation (Snyder, 2019). Unlike traditional narrative reviews, systematic reviews employ a structured and transparent process for identifying, screening, evaluating, and synthesising relevant literature, thereby enhancing the reliability and rigour of the research findings.

The study is theoretically grounded in the **Resource-Based View (RBV)** and the **Liquidity-Profitability Trade-off Theory**. The RBV argues that efficient utilisation of organisational resources can create sustainable competitive advantages (Barney, 1991). In the context of MSMEs, working capital efficiency may be viewed as a strategic capability that enables firms to utilise current assets effectively, improve operational performance, and enhance long-term competitiveness. Simultaneously, the liquidity-profitability trade-off perspective suggests that firms must maintain an optimal balance between liquidity and profitability because excessive or insufficient working capital can adversely affect organisational performance (Smith, 1980).

To ensure methodological rigour, the review followed the **PRISMA 2020 (Preferred Reporting Items for Systematic Reviews and Meta-Analyses)** framework (Page et al., 2021). Relevant studies were identified through a comprehensive search of major academic databases, including **Scopus, Web of Science, ScienceDirect, Emerald Insight, SpringerLink, Taylor & Francis Online, and Google Scholar**. The search strategy incorporated combinations of keywords such as *working capital management, working capital efficiency, cash conversion cycle, inventory management, accounts receivable, accounts payable, liquidity, profitability, financial performance, SMEs, and MSMEs*.



The literature search focused on studies published between **2003 and 2026**. The year 2003 was selected as the starting point because the seminal work of Deloof (2003) significantly advanced empirical research on the relationship between working capital management and corporate profitability. This period captures the evolution of working capital literature from foundational studies to recent contributions emphasising MSME sustainability, resilience, and financial performance.

Following the identification stage, duplicate records were removed and the remaining studies were screened based on titles and abstracts. Full-text articles were subsequently assessed against predetermined inclusion and exclusion criteria to ensure consistency in study selection. The criteria used in the review are presented in Table 3.

Criteria	Inclusion Criteria	Exclusion Criteria
Publication Type	Peer-reviewed journal articles	Editorials, conference abstracts, book reviews
Language	English-language publications	Non-English publications
Time Period	2003-2026	Studies published before 2003
Research Focus	Working capital management, MSMEs, SME finance, financial performance, liquidity, profitability, sustainability	Studies unrelated to financial management or MSMEs
Journal Quality	Scopus-indexed and recognised scholarly journals	Non-indexed articles and unpublished manuscripts
Study Design	Empirical, conceptual, and review studies	Opinion articles and non-academic publications
Unit of Analysis	MSMEs, SMEs, entrepreneurial ventures, small businesses	Large corporations without MSME relevance
Accessibility	Full-text articles available	Inaccessible or incomplete studies

Table 3. Inclusion and Exclusion Criteria

The selected literature was analysed using a concept-centric review approach (Webster & Watson, 2002). Rather than organising studies chronologically, the literature was classified into major dimensions of working capital efficiency, including cash management, inventory management, accounts receivable management, accounts payable management, and cash conversion cycle management. This approach facilitated the identification of recurring themes, theoretical relationships, and empirical findings across different economic contexts and industrial sectors.

The review incorporated seminal contributions from Deloof (2003), Lazaridis and Tryfonidis (2006), Padachi (2006), García-Teruel and Martínez-Solano (2007), Raheman and Nasr (2007), Shin and Soenen (1998), and Afrifa and Padachi (2016), together with recent MSME-focused studies. Particular emphasis was placed on examining the relationship between working capital efficiency and key financial performance indicators, including profitability, liquidity, operational efficiency, growth, and business sustainability.

To strengthen the conceptual foundation of the study, evidence from the reviewed literature was synthesised through **thematic analysis and theory-building procedures**. The synthesis identified consistent patterns regarding the role of efficient working capital practices in improving firm performance. These themes were subsequently integrated with theoretical insights from RBV and financial management theories to develop a comprehensive conceptual framework



and a set of research propositions explaining the direct influence of working capital efficiency on MSME financial performance.

Furthermore, the study draws contextual support from the empirical findings of Rosyadah et al. (2022), who analysed 310 MSMEs using Structural Equation Modelling (SEM) and reported significant relationships among working capital, financial performance, and business sustainability. Their findings provide contemporary evidence supporting the strategic importance of working capital management within MSMEs and reinforce the theoretical arguments developed in the present study.

Overall, the methodology provides a robust and transparent framework for synthesising extant knowledge on working capital efficiency and MSME performance. By systematically integrating theoretical perspectives and empirical evidence, the study contributes to the development of a comprehensive understanding of the mechanisms through which working capital efficiency influences profitability, liquidity, growth, and long-term sustainability.

Data Extraction

Following the final selection of eligible studies, a structured data extraction procedure was undertaken to ensure consistency, transparency, and comparability across the reviewed literature. Data extraction is a critical stage in systematic review studies because it facilitates the systematic collection of relevant information and reduces reviewer bias (Page et al., 2021).

For each selected article, information was recorded using a standardised data extraction form. The extracted variables included: (i) author(s) and year of publication, (ii) country or geographical context, (iii) research objectives, (iv) study design and methodology, (v) sample characteristics, (vi) measures of working capital efficiency, (vii) indicators of financial performance, (viii) theoretical foundations, and (ix) principal findings and conclusions. Additional attention was given to the dimensions of working capital management examined in each study, including inventory management, accounts receivable management, accounts payable management, cash management, and cash conversion cycle efficiency.

The extracted information was subsequently organised into thematic categories to facilitate comparison and synthesis of findings. Studies reporting significant relationships between working capital efficiency and profitability, liquidity, business growth, operational efficiency, and sustainability were grouped according to common themes. This process enabled the identification of dominant research streams, theoretical patterns, and areas requiring further investigation. Consistent with recommendations by Webster and Watson (2002), the review adopted a concept-centric rather than an author-centric approach, allowing the synthesis to focus on theoretical constructs and relationships rather than individual studies.

To improve analytical rigour, the extracted evidence was coded according to the directional nature of reported relationships (positive, negative, or mixed) between working capital efficiency and financial performance indicators. This coding process facilitated the development of a comprehensive conceptual framework and the formulation of research propositions grounded in existing empirical evidence.

Data Element	Description
Author(s) and Year	Bibliographic information of the study
Country/Context	Geographical setting of the research
Study Design	Empirical, conceptual, review, or mixed-methods
Sample Characteristics	Number and type of firms included
Working Capital Measures	Inventory turnover, receivables period, payables period, CCC, liquidity ratios



Financial Performance Measures	ROA, ROE, profitability, liquidity, growth, sustainability
Theoretical Foundation	RBV, Financial Management Theory, Trade-off Theory, etc.
Key Findings	Principal findings related to working capital efficiency
Research Implications	Theoretical and managerial implications

Table 4. Data Extraction Framework

Quality Appraisal

To strengthen the credibility and reliability of the review findings, the selected studies were subjected to a quality appraisal process. Quality assessment is essential in systematic reviews because it ensures that conclusions are derived from robust and methodologically sound evidence (Snyder, 2019).

The appraisal was conducted using five evaluation criteria adapted from established systematic review guidelines, namely: (i) clarity of research objectives, (ii) appropriateness of research design, (iii) adequacy of sample size and data sources, (iv) robustness of analytical methods, and (v) relevance of findings to working capital management and MSME financial performance. Each study was evaluated against these criteria and assigned a quality score ranging from 1 (low quality) to 3 (high quality).

Studies receiving higher ratings demonstrated clear theoretical foundations, rigorous empirical methodologies, adequate sample sizes, and strong evidence regarding the relationship between working capital efficiency and firm performance. Particular emphasis was placed on studies published in high-impact and Scopus-indexed journals to ensure the inclusion of reliable and academically rigorous evidence.

The quality appraisal process revealed that seminal studies such as Deloof (2003), Padachi (2006), García-Teruel and Martínez-Solano (2007), Raheman and Nasr (2007), and Afrifa and Padachi (2016) exhibited strong methodological quality and provided substantial evidence supporting the strategic importance of working capital management. Recent MSME-focused studies, including Rosyadah et al. (2022), were also found to contribute valuable contemporary insights regarding the role of working capital in improving profitability, sustainability, and organisational resilience.

Criterion	Assessment Focus
Research Objectives	Clarity and alignment with study purpose
Research Design	Appropriateness of methodology employed
Sample Adequacy	Sample size, representativeness, and data quality
Analytical Rigour	Statistical techniques and robustness of analysis
Relevance	Applicability to working capital efficiency and MSME performance

Table 5. Quality Appraisal Criteria



Quality Rating Scale

Score	Interpretation
3	High Quality
2	Moderate Quality
1	Low Quality

The incorporation of data extraction and quality appraisal procedures enhances the methodological rigour of the present study by ensuring that the conceptual framework and research propositions are derived from high-quality and systematically evaluated evidence. Consequently, the review provides a reliable foundation for understanding the mechanisms through which working capital efficiency influences MSME profitability, liquidity, growth, and long-term sustainability.

Results and Discussion

The systematic review reveals a consistent and positive relationship between working capital efficiency and the financial performance of MSMEs. Across the reviewed studies, efficient management of current assets and current liabilities was found to improve profitability, liquidity, operational efficiency, and business sustainability. Seminal studies by Deloof (2003), Padachi (2006), García-Teruel and Martínez-Solano (2007), and Afrifa and Padachi (2016) demonstrate that firms maintaining optimal levels of inventory, receivables, and payables generally achieve superior financial outcomes compared to firms exhibiting inefficient working capital practices.

A key finding emerging from the literature is the importance of the **cash conversion cycle (CCC)** as an indicator of working capital efficiency. Studies consistently report that a shorter cash conversion cycle is associated with improved profitability because firms recover cash more quickly from operational activities and reduce dependence on external financing (Lazaridis & Tryfonidis, 2006; Raheman & Nasr, 2007). Similarly, effective inventory management minimises holding costs and stock obsolescence, while efficient receivables management accelerates cash inflows and strengthens liquidity positions.

The findings further indicate that working capital efficiency contributes significantly to MSME sustainability. Due to limited access to long-term financing, MSMEs rely heavily on internally generated funds to support routine operations and growth initiatives. Consequently, efficient working capital management enhances organisational resilience, improves financial flexibility, and strengthens the firm's ability to withstand economic uncertainties. Recent evidence from Rosyadah et al. (2022) reinforces this argument by demonstrating a significant positive relationship between working capital, financial performance, and business sustainability.

From a theoretical perspective, the findings support the Resource-Based View (RBV), suggesting that effective working capital management constitutes a valuable organisational capability that enhances competitive advantage and long-term performance (Barney, 1991). Overall, the reviewed literature confirms that efficient working capital management is not merely a liquidity-maintenance tool but a strategic mechanism for promoting profitability, growth, and sustainable MSME development.

Managerial Implications

The findings of this study offer several important managerial implications for MSME owners, entrepreneurs, financial managers, and business practitioners. First, the review highlights that working capital efficiency should be viewed as a strategic financial management tool rather than merely an operational necessity. Effective management of cash, inventories, accounts receivable, and accounts payable enables MSMEs to maintain adequate liquidity while simultaneously improving



profitability and business sustainability. Managers should therefore establish formal working capital policies that balance liquidity requirements with profit-generating activities.

Second, MSME managers should pay particular attention to the management of the cash conversion cycle (CCC), as evidence suggests that a shorter CCC contributes significantly to improved financial performance. By accelerating receivable collections, optimising inventory levels, and negotiating favourable payment terms with suppliers, firms can improve cash flow availability and reduce reliance on costly external financing. This is particularly important for MSMEs, which often face credit constraints and limited access to long-term capital.

Third, inventory management should be prioritised as a critical component of working capital efficiency. Excess inventory increases storage, insurance, and obsolescence costs, while insufficient inventory may result in production disruptions and lost sales opportunities. Managers should implement inventory monitoring systems and demand forecasting techniques to achieve optimal stock levels and enhance operational efficiency.

Furthermore, the findings emphasise the importance of effective credit management practices. MSMEs should establish clear credit policies, conduct customer credit evaluations, and monitor receivables regularly to minimise delayed payments and bad debts. Timely collection of receivables improves liquidity positions and supports uninterrupted business operations.

The study also suggests that managers should integrate working capital indicators into their performance measurement systems. Regular monitoring of liquidity ratios, inventory turnover, receivable collection periods, payable periods, and cash conversion cycles can provide early warning signals of financial inefficiencies and assist managers in making informed financial decisions.

Finally, the results indicate that efficient working capital management contributes not only to short-term profitability but also to long-term organisational resilience and sustainability. Consequently, MSME managers should treat working capital efficiency as a strategic capability that supports business growth, enhances competitiveness, strengthens financial stability, and improves the firm's ability to withstand changing market conditions. Investing in financial planning, digital accounting systems, and employee financial management training can further improve working capital effectiveness and support sustainable enterprise development.

Policy Implications

The findings of this study provide important implications for policymakers, government agencies, financial institutions, and MSME support organisations aiming to strengthen the financial performance and long-term sustainability of Micro, Small, and Medium Enterprises (MSMEs). Given the significant contribution of MSMEs to employment generation, economic growth, innovation, and poverty reduction, improving working capital efficiency should be recognised as a strategic policy priority. Effective working capital management enables firms to maintain liquidity, improve profitability, and enhance resilience in dynamic business environments (Deloof, 2003; Padachi, 2006).

A primary policy implication concerns improving MSMEs' access to affordable working capital financing. Limited collateral, information asymmetry, and high borrowing costs often restrict access to formal financial institutions, resulting in persistent liquidity constraints for many small businesses. Governments should therefore strengthen credit guarantee schemes, subsidised loan programmes, and specialised working capital financing initiatives that reduce financial barriers and support business growth. Such interventions can help MSMEs maintain optimal liquidity levels while reducing excessive dependence on informal sources of finance (Afrifa & Padachi, 2016).

Another important implication relates to financial literacy and managerial capability development. Previous studies indicate that effective working capital management requires sound financial knowledge and systematic decision-making practices (Rosyadah et al., 2022). Consequently, public agencies, chambers of commerce, entrepreneurship development institutions, and industry associations should design targeted training programmes focusing on cash flow management, inventory



optimisation, budgeting, receivables management, and financial planning. Enhanced financial literacy can improve resource allocation decisions and strengthen overall business performance.

The findings also underscore the importance of promoting digitalisation and financial technology adoption among MSMEs. Digital accounting systems, inventory management software, cloud-based bookkeeping platforms, and electronic payment solutions can significantly improve the monitoring and control of working capital components. Policymakers should encourage the adoption of such technologies through financial incentives, technology grants, subsidised software programmes, and digital skill-development initiatives. Digital transformation can improve financial transparency, reduce operational inefficiencies, and facilitate better financial decision-making.

Furthermore, financial institutions should develop customised financing products tailored to the unique operational characteristics of MSMEs. Alternative financing mechanisms such as supply chain finance, invoice discounting, receivables financing, and trade credit support can address short-term liquidity challenges more effectively than conventional lending products. Expanding these financing options can improve cash flow management and reduce financial vulnerability among MSMEs.

The study also suggests the need for stronger regulatory frameworks aimed at reducing delayed payments in business transactions. Late payments from large corporations and public sector entities frequently create liquidity pressures for MSMEs. Therefore, governments should implement and enforce prompt payment regulations that ensure timely settlement of obligations and protect the financial stability of smaller enterprises (García-Teruel & Martínez-Solano, 2007).

Finally, working capital management should be incorporated into broader MSME development and industrial policies. National entrepreneurship programmes, financial inclusion initiatives, and MSME support schemes should explicitly recognise working capital efficiency as a critical driver of firm competitiveness, profitability, and sustainability. A coordinated policy approach involving governments, financial institutions, industry associations, and business support organisations can create an enabling ecosystem that empowers MSMEs to optimise working capital practices and achieve sustainable long-term growth.

10. Limitations and Future Research

Despite providing valuable insights into the relationship between working capital efficiency and MSME financial performance, this study has several limitations. First, it is based on a conceptual review and therefore does not empirically test the proposed framework and research propositions. Second, the review primarily focuses on studies published in English-language journals, which may limit the inclusion of relevant evidence from other contexts. Third, differences in industry characteristics and country-specific institutional environments may influence the generalisability of the findings. Future research should empirically validate the proposed framework using longitudinal and cross-country datasets, examine sector-specific variations, and explore the role of digital financial technologies, financial inclusion, and sustainability practices in enhancing working capital efficiency and MSME performance.

Conclusion

This study examined the relationship between working capital efficiency and the financial performance of Micro, Small, and Medium Enterprises (MSMEs) through a systematic review of the existing literature. The findings consistently indicate that efficient management of cash, inventory, accounts receivable, accounts payable, and the cash conversion cycle significantly contributes to improved profitability, liquidity, operational efficiency, and business sustainability. The review highlights that MSMEs with effective working capital practices are better positioned to optimise resource utilisation, maintain financial stability, and reduce dependence on external financing.

The study further demonstrates that working capital efficiency functions as a strategic organisational capability, supporting the assumptions of the Resource-Based View (RBV) and Liquidity-Profitability Trade-off Theory. In resource-constrained



MSME environments, efficient working capital management enhances financial resilience, supports growth, and strengthens competitive advantage.

By synthesising theoretical and empirical evidence, this study develops a conceptual framework that explains the direct influence of working capital efficiency on MSME financial performance. The proposed framework contributes to the literature by integrating diverse perspectives into a comprehensive understanding of MSME financial management. Overall, the study concludes that working capital efficiency is not merely an operational requirement but a critical strategic driver of profitability, sustainability, and long-term business success. Future empirical studies can validate and extend the proposed framework across different sectors and geographical contexts.

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