Impact of working capital on firm’s profitability

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Abstract

The purpose of this research is to find the relationship between working capital and firm’s profitability. Basically, to check the impact of working capital on firms profitability. The quantitative data is used in this research. The financials of the banks support me to check the impact whether it is positive or negative. I used certain test for this research i-e Regression model, Anova and descriptive analysis. These all test conclude that there is a positive relationship between working capital and firms profitability.

Keywords: Working Capital, Firm’s Profitability

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Introduction

JS Bank Limited is an auxiliary of JS Group, a standout amongst the more expanded monetary administration bunches working in Pakistan. Other than exceeding expectations in ventures, for example, asset management, investment banking, securities brokerage, commercial banking, insurance and trade finance. Jahangir Siddiqui Bank Limited was shaped because of merger of JS Investment Bank Limited with the commercial banking operations of American Express Bank Ltd Pakistan.

Jahangir Siddiqui Bank Ltd initiated its performance in Pakistan as a completely planned relies upon 30th Dec. Entire Jahangir Siddiqui Group additionally propelled Islamic banking and fund benefits through setting up a premier Islamic commercial bank beneath the brand of Islamic bank in 2006. Subsequent to entering the 70th year of his operation, Jahangir Siddiqui Bank Ltd has utilized a large portion of the cities. Right now JSBL have a strong and vast system size of more than 180 units crosswise over 100 urban communities, JSBL is all around ready to extend its system across the country.

HBL was the principal business bank established in 1947 in Pakistan. Consistently, the HBL has developed and has kept up its branch organize as the biggest exclusive keep money with more than 1,700 branches and 2,000 ATMs around the world, with a client base of more than 10 million.

Now a day it has been noticed that the company’s financial performance is dramatically changed therefore problematic issue for the company is working capital management. Most of the companies not focused on their working capital management with concentration because they do not consider there big reason for the downfall that’s why they suffer problem for the company and in this research will check the impact of equity capital on firm’s profitability because this is an alarming signal for the company. Most of the researchers used different variable to measure these impact. Example, Cash Conversion Cycle- Account Receivable Days , Inventories Day turnover and Accounts Payable Days because they stated in their research that if companies want to maintain their working capital management then they should have to minimize their working capital management. The other variable is debt to total assets which is also necessary to demoralized It affects working capital management of company.

The motivation behind this undertaking is to analyze the effect of equity capital management on the organizations financial performance. The aim behind this research is to show that the equity capital management is the very important factor, implies that executives should discover successful and proficient approaches to manage the cash available for day to day operations in request to accomplish the ideal effect. Quality working capital management leads to increase the cash flows and thus management of the firm needs minor external financing; in this manner, the likelihood of default for the firm is lessen. A significant element in working capital administration is income cycle. It described as the time lag between purchasing the inventory and collection of cash from the sales and your Account receivables. Despite the fact that it has the most development, it has a more prominent enthusiasm for working capital, and the budgetary needs of this organization will be more conspicuous. The cost of profits will also be higher, which will increase the higher default risk, interest rate and reduce profits. JS bank limited will get more benefit from this research because they get opportunity to know how it competitor utilized their working capital in the day to day operations and the management of the JS bank will easily identifying the master way and actions that they can be implement instantly. Moreover after the successful execution of the cash flows company haven’t required external finance and indisputably improved organization financial performance. Numerous analysts have taken a gander at capital prerequisites from alternate points of view and in various conditions. The accompanying was extremely fascinating for our research Abbassab Pourghizan and Milad Emam Jalili Pourchari, experimentally, investigated the influence of working capital on firm’s Profitability and judgment of stock market of Tehran Stock Exchange. Considering this goal, in 2006-2010, a sample of companies was registered and reviewed at the Stock Exchange of Tehran. In this research, variables have also been utilized to measure the impact of these two factors. Now the Predicted results from this research shows that there is an impact of working capital management on company’s profitability and the results

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conclude that management can raise their profitability by diminishing the cash conversion cycle and debt to total assets.

**Literature review**

Most exact investigations bolster conventional convictions about contributing and gainfulness, which will positively affect venture company’s decrease in productivity (forceful strategy) by diminishing the proportion of current advantages for add up to resources. Deloof (2003) broke down a case of Belgian organizations, and Wang (2002) dissected a case of Japanese and Taiwanese organizations, and underscored that the administration of working capital significantly affected corporate benefit and increment gainfulness by lessening the quantity of day by day accounts and diminishing stock. A short money cycle and net business cycle are identified with the organization’s better execution. What’s more, effective, productive capital administration is fundamental for making an incentive for investors. Shane Swann (1998) detailed a comparative specimen from a US firm, however utilized the Net Trading Cycle (NTC) as a complete instrument for working capital administration and demonstrated a negative connection among NTC and benefit. In any case, this relationship was exceptionally noteworthy when breaks down were found for a specific industry (Soenen, 1993). Jose, et al. (1996) led an industry investigation of the business and measured the present liquidity utilizing the income cycle. Controlling the business and size contrasts, they presume that liquidity administration is connected to more benefits for different enterprises. In any case, it is not quite the same as conventional convictions that putting more in the process of giving birth capital (moderate legislative issues) may likewise build gainfulness. At the point where the stock holds up, the cost of intrusions in the creation procedure, decreased supply costs, assurance from value changes and diminished business because of item deficiencies (Blinder and Maccini, 1991). Czyzewski and Hicks (1992) Moreover, we presume that associations that have a more prominent profit for assets have higher money related imperatives yet don’t see liquidity administration as a steady proportion of money and settled resources.

In one research (Deloof 2003) argued that most of the company’s invested a large amount of liquidity in working capital management. Hence, they were expected that the managed working capital increase the firm’s profitability What’s more, I think the connection between the working capital and profitability is critical. After the regression and correlation test the result stated that there is a significant inverse relationship between company’s income and the number of Account Receivables Days . Account Payables and Inventories. It means that If company has less profitable so it takes long period of time to pay its creditors because there is a significant negative relationship between these two variables. So it is important for the company to maintain its cash conversion cycle to increase their profitability. The Cash conversion cycle also plays a vital role to maintaining the working capital which impact on your profitability.

Shane and Swann ( 1998) underscore that working capital management was essential to make an incentive for investors (Shareholders). It was a venture way management significantly affected benefit and liquidity. Connection between the length of the net advertising cycle, corporate profitability, and hazard balanced stocks return utilizing the connection and elapse examination by industry and capital were explored severity Then found a solid negative connection between net lengths. The business cycle and its severity with the assistance of past research and data gave by banks. Moreover for this project took permission from JS and HBL management and filled up the consent form from their upper level management. Data will be safe and confidential and will only be used for this research.

**Methodology**

Examined the effect of working capital on profitability, the main focus of this research is to check the impact of labor capital management on firm’s performance. The regression analysis was anticipated with a sample of 255 firms listed on Thai Stock exchange from 2007 to 2009. Hence, the finding showed that there is an inverse relationship between profit and (CCC) Cash Conversion Cycle. It means that (CCC) cash conversion cycle increase the profitability will decline. Simply, the research conclude indirectly is that the working capital management interrupts your profitability.

This research is rely on multiple case study as methodology because in my research there is comparison between the two organizations “JS Bank” and “HBL” that’s why it’s based on multiple case study. The case study will focus on the financial performance of the two companies that whether changes in working capital affect the firm’s profitability.

The literature review and my working experience in “JS Bank” as well as with the use of secondary data. It will help me to identify many problems and the impact of business capital on organizations performance. The secondary data will be composed in the research to answer the questions.

The deductive approach is being acquire for this industry project where the financial performance for the “JS BANK” will be basically broken down and contrasted with the benchmark organization “HBL”. The reason for adopting the deductive approach is that because we are testing on previous data of the organization. Basically this research will be based on quantitative research. Secondary data will be used in this research because we are working on past data. This information is a sort of little data that another person gathers for another reason. To check the impact of working capital on firms performance the secondary data will be helpful because with the help of their published accounts we will conclude the findings that whether it affects or not on your profitability. The published accounts of “ JS Bank” and “HBL” are enough to give the conclusions on this research.

This task agrees to the moral necessities of research as per the materials specified. Members will be dealt with in an ethical way and will be dealt with to control potential disability. We furnish the best outcomes with the assistance of past research and data gave by banks. Moreover for this project took permission from JS and HBL management and filled up the consent form from their upper level management. Data will be safe and confidential and will only be used for this research.

**Results and Findings**

**HBL financial Highlights**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Revenue</th>
<th>Total Cost</th>
<th>Gross Profit</th>
<th>Operating Income</th>
<th>Operating Expenses</th>
<th>Net Income</th>
<th>Total Assets</th>
<th>Total Liabilities</th>
<th>Shareholders' Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$10,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$3,000</td>
<td>$1,000</td>
<td>$3,000</td>
<td>$10,000</td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>2008</td>
<td>$10,500</td>
<td>$5,500</td>
<td>$5,000</td>
<td>$3,500</td>
<td>$1,500</td>
<td>$3,500</td>
<td>$10,500</td>
<td>$5,500</td>
<td>$5,000</td>
</tr>
<tr>
<td>2009</td>
<td>$11,000</td>
<td>$6,000</td>
<td>$5,000</td>
<td>$4,000</td>
<td>$2,000</td>
<td>$4,000</td>
<td>$11,000</td>
<td>$6,000</td>
<td>$5,000</td>
</tr>
</tbody>
</table>

**JS Bank Financial Highlights**

<table>
<thead>
<tr>
<th>Year</th>
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<th>Gross Profit</th>
<th>Operating Income</th>
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<td>$2,000</td>
<td>$4,000</td>
<td>$11,000</td>
<td>$6,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>2008</td>
<td>$11,500</td>
<td>$6,500</td>
<td>$5,000</td>
<td>$4,500</td>
<td>$2,500</td>
<td>$4,500</td>
<td>$11,500</td>
<td>$6,500</td>
<td>$5,000</td>
</tr>
<tr>
<td>2009</td>
<td>$12,000</td>
<td>$7,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$3,000</td>
<td>$5,000</td>
<td>$12,000</td>
<td>$7,000</td>
<td>$5,000</td>
</tr>
</tbody>
</table>
The above mentioned results show the proper picture of our research. It tells you that which variable affects the firm’s profitability. The result shows that ROE, TAT and WC has a significant relationship with the firm’s profitability so it means that null hypothesis should be rejected and alternative hypothesis has to be accepted because the sig value of these variables is less than 0.05. It describes that there is a relationship between them so if these variables increase or decrease it affects the firm’s profitability. The other variable CR and WCT has the insignificant relationship between them but there sig value is greater than 0.05

The above readings of the result show that there is a 68% variation in dependent variable explained by model (independent variable). The “R-Square” explain variation and the ‘R’ value shows the correlation value so it means there is 0.824 correlations between the dependent and independent variable.
The main discussion in this research was to analyzing the relationship between the measures of working capital management and the performance of the company with respect to certain variables. We saw that there is a relationship between working capital and firms’ profitability. These results tell us about the impact of variables on firm’s performance. The major aim to check the impact of working capital on firm’s profitability. As we saw in the findings that it’s proven the working capital plays a vital role in company’s performance.

Regarding our hypothesis we conclude that our alternative hypothesis that there is a relationship between working capital and firms profitability is the one to be accepted and therefore we reject the null hypothesis. The conclusions are in confirmation with the other researchers which I mentioned in the literature review who also found a positive relationship between the measures of working capital management including ROE and total asset turnover and net margin. The main discussion in this research was to analyzing the performance of the company with respect to certain variables. We saw the findings tell us about the impact of variables on firm’s performance. The major aim to check the impact of working capital on firm’s profitability. As we saw in the findings that it’s proven the working capital plays a vital role in company’s performance. From the outcomes found in this investigation, which incorporates the accompanying, a few approach inquiries can likewise be utilized working capital administration ought to be a worry of all financial sectors and the necessities of the organization because every area of your company is related with the working capital. The cash conversion cycle is important for the working capital it has to be improved and for this treasury department of the company must be experienced. The effective policy is formulated for these components. If working capital maintained properly so your gross working capital turnover and current asset to total asset has also the significant positive impact on profitability.

Recommendations

In view of the above investigation, it can be inferred that these outcomes can be more reinforced if organizations deal with their capital in a more proficient manner. Capital administration signifies “overseeing current resources and current liabilities and financing of these present resources. In the event that these organizations deal with their income appropriately, Accounts receivable and stock legitimately, this will in the long run increment the benefit of these organizations. Later on, putting resources into Pakistan is genuinely necessary. We propose that further research be directed on a comparable theme with various organizations and broaden the example years. Additionally look into extension may reach out to the administration of staff capital parts, including money, buyer securities, obligation and stock administration.

References

Hina Agha (2014), European Scientific Journal. 10(1), 374-381
Abdul Raheman, Muhammad Nasr (2007), International Review of Business Research Papers. 3(1), 279-300

Table 6: ANOVA*

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>1658.349</td>
<td>1</td>
<td>1658.349</td>
<td>16.889</td>
<td>.003*</td>
</tr>
<tr>
<td>Residual</td>
<td>785.544</td>
<td>8</td>
<td>98.193</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2443.893</td>
<td>9</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), WC
b. Dependent Variable: NM

Table 7: Coefficients*

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
<td>Tolerance</td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>7.350</td>
<td>3.760</td>
<td>.824</td>
<td>1.955</td>
<td>.086</td>
</tr>
<tr>
<td>WC</td>
<td>2.512</td>
<td>.000</td>
<td>4.110</td>
<td>.003</td>
<td></td>
</tr>
</tbody>
</table>

Dependent Variable: NM

Tolerances =1.000 VIF =1.000

The another finding describes that overall model is significant and there is a relationship between the variables because the sig value of the anova model is less than 0.05 so null hypothesis should be rejected and alternative have accepted. The “t” value also proves that there is significant relationship between these variables because “t” value is greater than 2 which is 4.110. The Tolerance value tells about the model with its own threshold that if its value is greater than 0-2 so it’s acceptable otherwise reject. There is “VIF” value describes that there is a significant impact between the variables. There is relationship between Working capital and firm’s profitability.

Table 8: Hypothesis results

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Testing Specification</th>
<th>Empirical Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>H0: Firm profitability is significantly affected by working capital.</td>
<td>0.003</td>
<td>Accepted</td>
</tr>
</tbody>
</table>

Conclusion

Most Pakistani organizations contribute a lot of money in working capital. Along these lines, you can anticipate that a way will oversee capital available for use if it significantly affects the benefit of these organizations. We have found a significant positive relationship between the working capital and firm’s profitability. These results suggest that if company wants to maintain their position in the market and gets the good results so they have to properly workout on their working capital.

Regarding our hypothesis we conclude that our alternative hypothesis that there is a relationship between working capital and firms profitability is the one to be accepted and therefore we reject the null hypothesis. The conclusions are in confirmation with the other researchers which I mentioned in the literature review who also found a positive relationship between the measures of working capital management including ROE and total asset turnover and net margin. The main discussion in this research was to analyzing the performance of the company with respect to certain variables. We saw