World Bulletin of Management and Law (WBML)
Available Online at: https://www.scholarexpress.net
Volume-36, July -2024
ISSN: 2749-3601

EFFECT OF CAPITAL MANAGEMENT TO COMPANIES PERFORMANCE IN PAKISTAN TEXTILE SECTOR

Bunyod Usmonov
International School of Finance Technology and Science (ISFT)
Usmanov.b.a@yandex.ru

Article history:

Received: 10th May 2024
Accepted: 7th June 2024

Abstract:

The ongoing research examines how managing working capital influences a company's performance, considering the moderating impact of ownership structure. A sample of 77 companies over the period 2011-2015 was analyzed. Through a fixed-effect model, the study revealed a significant negative correlation between leverage, average collection period, and quick ratio with firm performance, whereas current ratio, account payable, and inventory turnover showed a positive impact on firm performance. Moreover, the study found that institutional ownership positively influences the relationship between working capital and firm performance, while managerial ownership has a negative influence. Hence, it is recommended that owners and managers handle their resources effectively to enhance profitability. Additionally, investors and shareholders should take into account the levels of institutional and managerial ownership when making investment decisions.

Keywords:

INTRODUCTION

Capital Management plays a crucial role in corporate financial strategies to maximize shareholder wealth. It pertains to the management of short-term resources involving investment decisions and short-term financing (Filbeck & Krueger, 2005; Van James, 2004). Effective working capital management aims to optimize returns by managing current assets and liabilities efficiently. Many businesses across different sectors have recognized the significance of efficient working capital management for sustainability and growth. Studies have suggested that firm profitability is significantly influenced by how working capital is managed(Şen, Köksal, & Oruç, 2009; Tsagem, Aripin, & Ishak, 2014). For small firms that face challenges in accessing capital from markets compared to larger counterparts, policies regarding working capital management are particularly important. The main goal of working capital management is to ensure that each element of working capital is utilized optimally, involving inventory, accounts payable, accounts receivable, marketable securities, and cash management. It is crucial to strike a balance between short-term assets to mitigate liquidity risks and prevent overinvestment in current assets that could hamper profitability(Baños-Caballero, García-Teruel, & Martínez-Solano, 2012; Fazzari & Petersen, 1993; Shezad, Jan, Gulzar, & Ansari, 2014; Walker, 1989; Whited, 1992). Moreover, ownership structure and corporate governance are also vital factors in efficient working capital management. Poor working capital management and weak ownership structure can have a detrimental impact on firm value and profitability.

Several studies have highlighted the issue of working capital management problems in many companies (Kieschnick, Laplante, & Moussawi, 2006; Noreen, Khan, & Abbas, 2009; Padachi, 2006), emphasizing the critical role it plays as the lifeblood and nerve center of a firm. Despite this recognition, there is still a lack of awareness regarding the significance of working capital management. Trends in working capital levels globally have shown a decline over the years, with Asian and American companies exhibiting particularly poor performance in this aspect(Paul, Devi, & Teh, 2012; Şen et al., 2009; Yusuf & Idowu, 2012). Working capital management is a dynamic aspect of firm investment crucial for continuous operations and the company's survival, impacting solvency, profitability, and liquidity. Mismanagement of working capital can have adverse effects on a firm's liquidity, profitability, and overall performance, which in turn can influence shareholder wealth maximization. Various studies(Bagh, Nazir, Khan, Khan, & Razzaq, 2016) have explored the relationship between working capital management and firm performance, considering factors such as size, leverage, and growth. Inappropriate use of working capital management practices can negatively impact firm performance, while effective management can enhance it. For example, a study focusing on the manufacturing sector found that inventory turnover, conversion cycle, and average payment period were

World Bulletin of Management and Law (WBML)
Available Online at: https://www.scholarexpress.net
Volume-36, July -2024
ISSN: 2749-3601

negatively correlated with firm performance, whereas the average collection period had a positive and significant effect on performance.

LITERATURE REVIEW

A rich literature is available on working capital management and firm performance relationship. This section included some of previous scholar efforts in relevant study.

In a study spanning from 1996 to 1999, Filbeck and Krueger analyzed data from 26 industries comprising 970 firms, suggesting that firms can enhance funding availability for project development or reduce financial costs by minimizing investments in working capital. Another study by Azam and Haider on UL firms revealed a detrimental impact of liquidity and a positive effect of debt ratio on firm performance. Lazaridis and Tryfonidis delved into firm performance and working capital management in Athens Stock Exchange firms over four years (2001-2004) with a sample size of 131, uncovering that leverage and cash conversion cycle significantly and adversely affected firm performance. Conversely, there was a positive correlation between fixed financial assets and firm performance, while accounts receivable days and inventory turnover days displayed a negative relationship with firm performance. Efficient management of the cash conversion cycle and its components were deemed critical for enhancing firm performance according to the findings.

Juan García-Teruel and Martinez-Solano's examination of Spanish small and medium enterprises over the period 1996-2002, involving a sample of 8872 firms, highlighted the highly negative and significant impact of accounts payable, inventory days, and accounts receivable on firm profitability. They also noted a significantly negative relationship between the cash conversion cycle and firm performance, positing that reducing the length of the cash conversion cycle could lead to an improvement in firm performance.

A study conducted by A. Gill, Biger, and Mathur in 2010 focused on US manufacturing firms, analyzing the impact of working capital management on performance from 2005 to 2007. The research revealed that the cash conversion cycle (CCC) had a positive effect on firm performance, while receivable collection periods negatively affected firm performance. Efficient management of the CCC and reducing accounts receivable were identified as strategies to enhance firm profitability.

Kaur and Singh's 2013 study on the Bombay Stock Exchange examined effective working capital management using a sample of 200 firms from 2000 to 2010. The study calculated the working capital score of each firm based on normalized days working capital, operating cycle, and cash conversion efficiency (CCE), concluding that efficient capital management significantly influences firm performance.

Ownership structure, as highlighted by Yusoff et al. (2013) and James (1999), plays a crucial role in corporate governance, directly impacting firm performance. Wilson, Plumley, & Ramchandani (2013) emphasized that a sound ownership structure is a key success factor for firms, leading to improved performance and reduced agency costs. The ownership structure, according to Ararat, Black, & Yurtoglu (2017), markedly affects firm performance, with potential for managers to boost profitability by optimizing accounts payable, inventory accounts, and days of accounts receivable. Shah, Gujar, & Sohu (2018) discovered that the cash conversion cycle, inventory turnover, and accounts payable significantly negatively affect firm performance, while the operating cycle has an insignificant impact on performance in chemical and pharmaceutical companies in Pakistan. Sharif & Islam (2018) studied the effect of working capital management on firm profitability, identifying accounts receivable, accounts payable, and the cash conversion cycle as having a positive and significant effect on firm performance

RESEARCH METHODOLOGY

The current study aims to investigate effect of working capital management and firm performance with the moderating role of ownership structure. A sample of 77 firms for the period 2011-2015 was selected through random sampling technique Data were collected from the data base of annual reports, Pakistan Stock Exchange, State Bank of Pakistan and Bureau of statistics.

Table 1. Variables Measurement

Variable	Measurement	Expected Relationship	Type
Return on Assets(ROA)	Net Income/Total Assets	+/-	Dependent
Leverage	Total Debit/Total Assets	-	Independent

World Bulletin of Management and Law (WBML)
Available Online at: https://www.scholarexpress.net
Volume-36, July -2024
ISSN: 2749-3601

Average Collection Period (ACP)	(Account Receivable / Credit Sale) *Days	-	
Quick Ratio	(C.L- Inventory)/ C. L	-	Control Variable Current Ratio (CR)
	Current Assets / Current Liabilities		+
Account Payable (AP)	(A.P / CGS) * 365	+	Inventory Turn Over
(IT)	(CGS / Average Inventory) *365	+	
Cash Conversion Cycle (CCC)	ACP+IT-AP	+/-	
Firm size (Size)	Ln (Total Assets)	-	
Managerial Ownership (M.O)	Share Percent Held via Manager	+/-	Moderating Variable
Institutional Ownership (I.O)	share Percent Held via Institution	+/-	

RESULTS AND DISCUSSION

Table 2 shows that the mean return on assets is .04551 with standard deviation 0.1252. Furthermore, mean value of leverage is .6310 while deviating with a value 0.2877. ACP means is 41.3812 deviating with a value of 86.59. The mean for Quick ratio is .5808 with showing variation of 1.3113. The means and standard deviation value of CR is 1.2875 and 1.2010. AP means value is 81.83 and standard deviation value is 313.02. Maximum and minimum days of AP is 5924 and .52222 days respectively. Furthermore, to convert inventory into sales, firm will take 37.11 days with standard deviation of 594.83. The means value for CCC is 94.89 which is deviating with a value 434.28. The range shows that maximum days for CCC is 6132.80 and minimum days for CCC is -1819. The mean value 14.75 for firm size deviating with a value 1.2764. The means value of managerial ownership is 48.13. Institutional ownership means value is 14.3572 with standard deviation of 19.5808. Table 4.2 shows detail descriptions of variables.

Table 2. Descriptive Statistics

Variable	Obs	Mean	Std. Dev	Min	Max
ROA	462	0.0455156	0.125233	-0.7324249	1.22441
Lev	462	0.6310708	0.287758	0.0072852	2.709904
ACP	462	41.38123	86.59031	0.0225777	1195.507
QR	462	0.5808886	1.311382	-14.29908	9.317722
CR	462	1.287509	1.201087	0.0647492	11.81151
AP	462	81.83588	313.0291	0.5222926	5924.423
IT	462	37.11923	594.8342	0.0324741	12789.68
CCC	462	94.89364	434.2866	-1819.901	6132.804
Size	462	14.75143	1.276466	10.8778	18.39072
M.O	462	48.13448	26.85413	0.0269	96.13
I.O	462	14.35729	19.58086	0.0000	78.97

World Bulletin of Management and Law (WBML)
Available Online at: https://www.scholarexpress.net
Volume-36, July -2024
ISSN: 2749-3601

RESULTS

In table 3 represent the fixed effect model with robust test result of all three model, in which model 1 indicates working capital management relationship with firm performance. Model 2 and 3 includes moderating effect managerial ownership and institutional ownership in relationship between working capital management and performance of firm respectively.

F value= 8.2711 with P value= 0.000 in model 1 shows highly significant fitness of the overall model. The value of R square indicates that 55.8% variation has been explained by working capital in performance of firm giving an idea that all independent variables (Leverage and Average collection period) including control variables (QR, CR, AP,IT,CCC and firm size) bring 55.8% variation in the performance of the textile sector. The outcome of model 1 indicates that firm performance is negatively and significantly affected by leverage, ACP, QR. Moreover, CR, AP and IT positively and significantly effects firm performance.

F value= 6.98109 with P value= 0.000 in model 3 shows that the overall model is significantly fit. The increase in R square value from .5587 to .569647 give a deep understanding about the moderating effect of institutional ownership in working capital and firm performance relationship. Furthermore, an interactive term of institutional ownership has changed the coefficient and significance level of leverage, ACP and QR. Institutional ownership has positive significant relationship with firm performance. Additionally, leverage with interactive term of institutional ownership has inverse and significant effect on firm performance, while ACP with interactive term of institutional ownership has negative but insignificant effect on firm performance found. Furthermore, taking the interactive term of institutional ownership, CCC didn't show any effect. Hence, the results strongly support the hypotheses that there is a moderating role of institutional ownership on the relation between firm performance and working capital management.

Table 3. Fixed Effect Model Result with Robust Test

Variable	Model 01	Model 02	Model 03
Constant	0.4016 (1.7349) *	0.571688 (2.4167) **	0.440235 (1.8446) *
Lev	−0.132469 (−2.2679) **	−0.399044 (−4.1679) ***	−0.106407 (−2.0365
ACP	−0.0005321 (−4.4889) ***	−0.0003874(−2.1094) **	−0.000494(−2.1305)
QR	−0.024006 (−2.0664) **	−0.029630 (−3.0036) ***	−0.018328 (−1.6915
CR	0.0235618 (2.3607) **	0.0301819 (2.8262) ***	0.0194178 (1.9944)
AP	5.80101e-05 (1.8085) *	3.3726e-05 (0.9343)	6.53321e-05 (1.2892
IT	3.48912e-06 (5.5821) ***	3.52961e-06 (8.9062) ***	2.9703e-06(4.8094)
CCC	3.46862e-05 (−1.1112)	−5.5044e-05(−2.1814) **	−2.3306e-05 (−0.814
Size of Firm	−0.0181977 (−1.3319)	−0.0198615 (−1.4490)	−0.0234044 (−1.610
M.O	-	−0.002407(−3.5349) ***	-
Lev*M.O	-	0.00431039(4.3523) ***	-
ACP*M.O	-	−1.53324e-06 (−0.3027)	-
I.O	-	-	0.0044849 (4.1298)
Lev*I. O	-	-	−0.005482 (−2.0154

World Bulletin of Management and Law (WBML)
Available Online at: https://www.scholarexpress.net
Volume-36, July -2024
ISSN: 2749-3601

ACP*I.O	-	-	−6.06905e-07 (−0.07
R-Square	0.558733	0.573679	0.569647
F Statistics	8.27112	7.36865	6.98109
P-value	0	0	0

Note: Figures in the parentheses are *t*-statistics while, ***, ** and * shows significance at the1%, 5% and 10% levels, respectively.

CONCLUSION

In order to ensure the sustainability and success of a company, it is essential for it to maintain an adequate level of working capital. The present research aims to examine the impact of working capital on firm performance, considering the moderating influence of ownership structure within the textile sector. The study determined that a fixed effect model was the most appropriate for achieving the research goals. Initially, the model recognized that firm performance is influenced by the management of working capital, and subsequently, it assessed the moderating effect of ownership structure on this relationship. The study results revealed that firm performance is negatively and significantly affected by Leverage, Average collection period, and Quick ratio. On the other hand, firm performance is positively and significantly impacted by Current ratio, Accounts payable, and Inventory turnover. Moreover, both managerial and institutional ownership significantly influence the relationship between working capital and firm performance. The study findings suggest that enhancing firm performance and maximizing shareholder wealth can be achieved by reducing collection periods, efficiently managing cash conversion, and maintaining a low level of the current ratio. In conclusion, the empirical findings of this study provide insights into the importance of effective working capital management in ensuring firm performance.

REFERENCES

1. Azam, M., & Haider, S. I. (2011). Impact of working capital management on firms' performance: evidence from non-financial institutions of KSE-30 index. *Interdisciplinary journal of contemporary research in business, 3*(5), 481-492.
2. Bagh, T., Nazir, M. I., Khan, M. A., Khan, M. A., & Razzaq, S. (2016). The impact of working capital management on Firms Financial Performance: Evidence from Pakistan. *International Journal of Economics and Financial Issues, 6*(3), 1097-1105.
3. Baños-Caballero, S., García-Teruel, P. J., & Martínez-Solano, P. (2012). How does working capital management affect the profitability of Spanish SMEs? *Small Business Economics, 39*(2), 517-529.
4. Deloof, M. (2003). Does working capital management affect profitability of Belgian firms? *Journal of business finance & Accounting, 30*(3-4), 573-588.
5. Fazzari, S. M., & Petersen, B. C. (1993). Working capital and fixed investment: new evidence on financing constraints. *The RAND Journal of Economics*, 328-342.
6. Filbeck, G., & Krueger, T. M. (2005). An analysis of working capital management results across industries. *American Journal of Business, 20*(2), 11-20.
7. Gill, A., Biger, N., & Mathur, N. (2010). The relationship between working capital management and profitability: Evidence from the United States. *Business and economics journal, 10*(1), 1-9.
8. Howorth, C., & Westhead, P. (2003). The focus of working capital management in UK small firms. *Management Accounting Research, 14*(2), 94-111.
9. James, H. S. (1999). Owner as manager, extended horizons and the family firm. *International journal of the economics of business, 6*(1), 41-55.
10. Juan García-Teruel, P., & Martinez-Solano, P. (2007). Effects of working capital management on SME profitability. *International Journal of Managerial Finance, 3*(2), 164-177.
11. Karim, R., Al-Mamun, M. A., & Miah, M. T. (2017). Relationship Between Working Capital Management Efficiency and Profitability: A Comparative Study on Square Pharmaceuticals Limited and Beximco Pharmaceuticals Limited, in Bangladesh. *International Journal of Economics, Finance and Management Sciences, 5*(2), 121-128.
12. Kaur, H. V., & Singh, S. (2013). Managing efficiency and profitability through working capital: An empirical analysis of BSE 200 companies. *Asian Journal of Business Management, 5*(2), 197-207.

World Bulletin of Management and Law (WBML)
Available Online at: https://www.scholarexpress.net
Volume-36, July -2024
ISSN: 2749-3601

13. Paul, S. Y., Devi, S. S., & Teh, C. G. (2012). Impact of late payment on Firms' profitability: Empirical evidence from Malaysia. *Pacific-Basin Finance Journal, 20*(5), 777-792.
14. Raheman, A., & Nasr, M. (2007). Working capital management and profitability–case of Pakistani firms. *International review of business research papers, 3*(1), 279-300.
15. Şen, M., Köksal, C. D., & Oruç, E. (2009). *Relationship between the efficiency of working capital management and company size.* Paper presented at the 12Th International Conference On Finance & Banking: Structural & Regional Impacts Of Financial Crises.
16. Shah, B., Gujar, M. A., & Sohu, N. U. (2018). The Impact Of Working Capital Management On Profitability: Case Study Of Pharmaceutical And Chemical Firms Listed On Karachi Stock Exchange. *International Journal of Economics, Commerce and Management*, 200-220.
17. Sharif, M. A., & Islam, M. R. (2018). Working Capital Management a Measurement Tool for Profitability: A Study on Pharmaceutical Industry in Bangladesh. *Journal of Finance and Accounting, 6*(1), 1.