World Bulletin of Management and Law (WBML)
Available Online at: https://www.scholarexpress.net
Volume-37, August -2024
ISSN: 2749-3601

CAPITAL ASSETS MANAGEMENT OF PAKISTAN COMPANIES

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Article history:

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

Abstract:

The current study investigates the effect of working capital management on a company's performance, taking into account the moderating role of ownership structure. Utilizing a fixed-effect model, the research found a notable negative relationship between leverage, average collection period, and quick ratio with firm performance, while current ratio, accounts payable, and inventory turnover positively influenced performance. Therefore, it is suggested that owners and managers optimize their resource management to improve profitability. Furthermore, investors and shareholders are advised to consider the extent of institutional and managerial ownership when making investment choices.

Keywords: quick ratio, working capital

INTRODUCTION

Capital management is essential to corporate financial strategies aimed at maximizing shareholder wealth. It involves the administration of short-term resources, including investment choices and short-term financing (Filbeck & Krueger, 2005; Van James, 2004). The goal of effective working capital management is to enhance returns by efficiently handling current assets and liabilities. Many companies across various sectors acknowledge the importance of managing working capital effectively for their sustainability and growth, as research indicates that firm profitability is significantly affected by working capital management practices.

Numerous studies have pointed out the challenges related to working capital management in many organizations (Kieschnick, Laplante, & Moussawi, 2006; Noreen, Khan, & Abbas, 2009; Padachi, 2006), highlighting its vital function as a fundamental component of a firm. Nonetheless, awareness of the importance of working capital management remains limited. Trends in global working capital levels have shown a downward trajectory over recent years, with companies in Asia and America demonstrating particularly weak performance in this regard (Paul, Devi, & Teh, 2012; Şen et al., 2009; Yusuf & Idowu, 2012). Working capital management is a dynamic element of firm investment essential for ongoing operations and survival, affecting solvency, profitability, and liquidity. Poor management of working capital can negatively impact a firm's liquidity, profitability, and overall performance, subsequently influencing the goal of maximizing shareholder wealth.

LITERATURE REVIEW

There is an extensive body of literature examining the connection between working capital management and firm performance. This section summarizes some of the contributions made by previous scholars in this area.

In a study by A. Gill, Biger, and Mathur in 2010, the focus was on U.S. manufacturing firms and the impact of working capital management on performance from 2005 to 2007. The research revealed that the cash conversion cycle (CCC) positively influenced firm performance, while longer receivable collection periods had a negative impact. The authors identified efficient management of the CCC and a reduction in accounts receivable as key strategies for improving firm profitability.

Juan García-Teruel and Martinez-Solano conducted an analysis of Spanish small and medium enterprises from 1996 to 2002, using a sample of 8,872 firms. Their findings indicated a strong negative and significant effect of accounts payable, inventory days, and accounts receivable on firm profitability. They also observed a significantly adverse relationship between the cash conversion cycle and firm performance, suggesting that shortening the cash conversion cycle could enhance firm performance. Kaur and Singh's 2013 study of the Bombay Stock Exchange analyzed effective working capital management using data from 200 firms from 2000 to 2010. The researchers calculated a working capital score for each firm based on normalized days working capital, operating cycle, and cash conversion efficiency (CCE), concluding that effective capital management plays a significant role in influencing firm performance.

According to Ararat, Black, and Yurtoglu (2017), the ownership structure has a considerable impact on firm performance, providing managers with opportunities to enhance profitability by optimizing accounts payable, inventory, and days of accounts receivable. Meanwhile, Shah, Gujar, and Sohu (2018) found that in the chemical and pharmaceutical industries in Pakistan, the cash conversion cycle, inventory turnover, and accounts

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payable negatively affected firm performance significantly, while the operating cycle had an insignificant effect.

ANALYSIS AND RESULTS

Table 1 presents the following statistical data: the mean return on assets is 0.04551, with a standard deviation of 0.1252. The average leverage is recorded at 0.6310, accompanied by a standard deviation of 0.2877. The mean accounts payable (AP) value is 39.4112, with a deviation of 84.59. The mean quick ratio stands at 0.5808, reflecting a variation of 1.3113. For the current ratio (CR), the mean is 1.3275, with a standard deviation of 1.2310. The mean value for accounts payable (AP) is 83.78, with a standard deviation of 313.02. The maximum and minimum days for accounts payable are 5924 and 0.52222 days, respectively. The average time required to convert inventory into sales is 37.11 days, with a standard deviation of 594.83. The mean cash conversion cycle (CCC) is 93.79, with a deviation of 425.28. The maximum days for the CCC is 6132.80, while the minimum is -1819 days. The average firm size has a mean value of 14.75, with a deviation of 1.2764. Managerial ownership averages 48.13, and institutional ownership has a mean value of 14.3572, with a standard deviation of 19.5808. Table 1 provides detailed descriptions of these variables.

Table 1. Descriptive Statistics of 71 companies of Pakistan from 2017-2021

Variable	Obs	Mean	Std. Dev	Min	Max
ROA	452	0.0455156	0.125233	-0.7324249	1.22441
Leverage		0.6310708	0.287758	0.0072852	2.709904
ACP		39.41123	84.59031	0.0225777	1195.507
QR	452	0.5808886	1.311382	-14.29908	9.317722
CR		1.327509	1.231087	0.0647492	11.81151
AP		83.78588	313.0291	0.5222926	5924.423
IT		37.11923	594.8342	0.0324741	12789.68
CCC		93.79364	425.2866	-1819.901	6132.804
Size		14.75143	1.276466	10.8778	18.39072
M.O		48.13448	26.85413	0.0269	96.13
I.O		14.35729	19.58086	0.0000	78.97

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In table 2 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 2. Fixed Effect Model (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
ACP*I.O	-	-	−6.06905e-07 (−0.07
R-Square	0.558733	0.573679	0.569647

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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

To ensure a company's sustainability and success, maintaining a sufficient level of working capital is crucial. This research investigates the effect of working capital on firm performance, with a focus on the moderating role of ownership structure in the textile sector. The study concluded that a fixed effect model was the ideal approach for addressing the research objectives. Initially, the model identified that the management of working capital significantly impacts firm performance and then evaluated the moderating effect of ownership structure on this relationship. Results indicated that firm performance is negatively and significantly impacted by leverage, average collection period, and quick ratio. Conversely, firm performance is positively and significantly influenced by current ratio, accounts payable, and inventory turnover. Additionally, both managerial and institutional ownership significantly affect the relationship between working capital and firm performance. The findings imply that improving firm performance and maximizing shareholder value can be achieved by shortening collection periods, efficiently managing cash conversion, and keeping the current ratio low. In summary, the empirical results highlight the critical role of effective working capital management in enhancing firm performance.

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