The Effects of Working Capital Management on the Financial Performance of Trading Companies

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ABSTRACT

The efficiency with which a business manages its working capital determines how well it can fulfil its operating expenses and its short-term debt obligations. It is important for businesses to balance the demands of effective working capital management with their overall financial and operational health. It is anticipated that the strong financial performance will be supported by an effective Working Capital Management. This research set out to learn how effective management of a company's working capital can boost its bottom line. Working capital management effectiveness was studied by analysing the cash conversion cycle. Here, we ask, "To what extent does the management of working capital affect the financial results of trading firms?" — Working capital management is found to have a significant impact on bottom line results, according to the literature. The assumption was that a company's bottom line would benefit from better attention to its working capital. The relationship between the key performance indicator return on assets and the controllable factor of working capital management was studied.

Introduction

Due to the high proportion of working capital in a business, modern financial management—and particularly the management and control of working capital—requires substantial focus and is a challenging task. Working capital management is the process of overseeing the administration of short-term assets that have an accounting year to convert into cash and short-term liabilities that are payable within a year. Financial management, and working capital management in particular, is crucial to a company's ability to succeed. When a company isn't properly managing its finances, it can suffer. Effective financial management is a cornerstone of any successful business strategy because of the value it generates for a company's shareholders. Furthermore, a company's performance and liquidity are both impacted by the quality of its working capital management, making this aspect of business operations particularly important.

Review of Literature

Shin and Soenen (1998) examined the relationship between the net-trade cycle, a metric for measuring the efficacy of working capital management, and corporate profitability using data from 58,985 enterprises between 1975 and 1994 as a sample. They found that the length of a company's net-trade cycle had a negative impact on its profitability.

Deloof (2003) examined the working capital management and corporate profitability of 1,009 big Belgian non-financial corporations from 1992–1996, using a sample of these businesses. Cash conversion cycle length and days' worth of outstanding accounts receivable and inventory were found to have a negative relationship with profitability (as assessed by gross operating income). He said that managers might increase profits by reducing accounts receivable and stock on hand. When a business has lower profits, it often takes longer to make payments.

Working capital management was analysed in relation to the success of companies trading on the Athens Stock Exchange by Lazaridis and Tryfonidis (2006). Between 2001 and 2004, 131 publicly traded firms were employed to analyse this correlation. In a regression analysis, it was shown that the cash conversion cycle's profitability was significantly correlated with the gross operational profit. The findings provided support for the hypothesis that managers can increase shareholder returns by maintaining a healthy cash conversion cycle.

To develop their approach to valuation, Raheman and Nasr (2007) looked at data from a sample of 94 Pakistani companies listed on the Karachi Stock Exchange. Short-term working

capital financing was found to be trending increasing, and the results showed a link between heavy investment in inventory and receivables and poor profit margins.

Analysis and Interpretation

In order to better understand the relationship between Net Profitability and other metrics, the average collection period, average inventory turnover in days, average payment period, and cash conversion cycle were all analysed. The data indicate that longer collection periods are detrimental to a company's bottom line. When the time frame is cut down, profits go up. The average payment duration has a positive correlation with profitability (0.127), indicating that more favourable payment conditions lead to increased earnings. By decreasing the time it takes to turn capital into profits, businesses can boost their bottom lines and provide greater value to their shareholders.

The findings of this study indicate a connection between a company's working capital and its bottom line. Financial managers must pay close attention to liquidity because it has a direct impact on profits. In order to maximise shareholder value, businesses should have a solid procedure in place for collecting payments from customers and transferring those funds to pay suppliers and restock inventory.

Conclusion

Huge cash reserves are where much of the trading industry's working capital is stored. The way these businesses manage their working capital is, therefore, likely to have a major impact on their bottom lines. This study found a negative connection between return on assets, inventory turnover, and total cost of capital for CSE trading enterprises. According to the results, managers can increase returns to shareholders by maintaining reasonable levels of accounts receivable, payable, and inventories. In addition, the results may be enhanced further if the companies better manage their working capital, as shown in the preceding research.

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