

Article Type: Original Article

## Navigating Financial Seas: The Influence of Working Capital Dynamics on SME Textile Sector Performance in Pakistan, Enhanced by Moderating Control Environments

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Received: 18-03-2022, Revised: 04-11-2022, Accepted: 13-11-2022

### ABSTRACT

*Working capital (WC) is an essential asset to meet the daily working charges, therefore, an appropriate method of WC is a key to guarantee a strong soundness of financial position for the organization. However, Pakistan textile Small and Medium Enterprises (SMEs) are struggling to implement suitable WC management leading to negative effect on financial performance. To address this issue, this study considered the role of WC management in the financial position of SMEs. Data were collected from textile SMEs in Pakistan and analyzed by using Smart PLS 3. It is observed that WC management has a positive role in the promotion of financial performance. The present study has advanced several practical identifications in connection with WC and relevant management practices in cloth and garments textile sector of SMEs Punjab, Pakistan.*

**Keywords.** Working Capital Management, Financial Performance, Working Capital Components, Control Environment, Pakistani Textile Industry.

**Publisher:** ASIAN ACADEMY OF BUSINESS AND SOCIAL SCIENCE RESEARCH (PRIVATE) LIMITED

**Publishing Address:** 81-G Defence Rd, Dream Gardens, Lahore

**Publishing Country:** Pakistan



**Volume 2: Issue 1**

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How to Cite: Panichakarn, B. (2022). Navigating Financial Seas: The Influence of Working Capital Dynamics on SME Textile Sector Performance in Pakistan, Enhanced by Moderating Control Environments. *Int. J. Contemp. Bus. Lit.* 2(1), 40-50.

## INTRODUCTION

Small and Medium Enterprises (SMEs) are a primary source for work age (Asad et al., 2018). SMEs have been supposed universally as a motor of development and advancement (Asad et al., 2020). The public authority recognizes the financial advancement aggravate of SMEs that given distinctive business supports projects to guarantee the manageable development of economy (Arshad & Arshad, 2019). However, the Pakistani government dispatches a few activities to work with and advance the extension of the SMEs. These activities intend to make the official and orderly environments to help redesigning of organization level abilities, broadening, and formation of new firms (Arshad & Arshad, 2019). It indicates by what means the Pakistani government manages dealings with respect to the improvement of the SMEs in Pakistan to develop in their own field along with uplifting their standard as the top one in the industry.

Anyhow, coming to this new year, use of business help administrations given by the public authority should be viewed as weak, particularly among small measured SMEs (Shamsuddin et al., 2020). In any case, it was raised that SMEs add to joblessness in view of weaknesses including their exercises especially in under developing countries with payable limited assessment cut off and ability to accept large threats that are necessarily supporting (Katua, 2014). To help the economic development and improve quick advancement towards accomplishing the National Economic Policy and Vision Green Pakistan, an attractive business climate should be kept under attention which is a core to expand open doors for the upgrade of SME execution. The commitment of SMEs towards FP is acknowledged on a universal level currently (Kwamega et al., 2015). In Pakistan, SMEs have critical focus with 65.4% in Punjab. Assessed number of SMEs in Pakistan is 3.2 million out of which 30% are not working (Haider et al., 2017). Now a days SMEs have a significant effect on the economy of a country (Khan, 2016). An alternative is the dangers for the existence and execution of a business (Boin, 2009; Comfort, 2002; Williams et al., 2017). Similarly, COVID-19 become a danger and ordeal to the business world in specific locations as well as to the international business of people. FP has been seen uniquely to its capacity of return on benefit that becomes very evident when we analyze it from the customer's point of view (Akintimehin et al., 2019; Otekunrin et al., 2018). Consequently, FP is not just seen by its capacity to capitulate returns; it stresses on the client's characterization as well. With the further study, it showed us the impacts of panel scope and board organization presence of the Nigerian banks, utilizing budget summaries five banks more than nine years' time. Those studies have been assembled and divided into two classes: The first one is intended to concentrate around FDI or FP among nations whereas the second one is considered zeroed in the FDI or FP of a country. (Bebeji et al., 2015). In this way, the possibility that the WC is being supervised appropriately, we can take wise theory choices which stimulate excellent FP (Padachi, 2006).

Previous studies have inspected the WC. However, in order to cover this literature gap, this study examined the relationship of WC and CE with FP as the working capital relation with CE as a moderator on FP of cloth and garments textile sector of SMEs in Pakistan has not been evaluated. Many studies have been conducted on working capital (Aregbeyen, 2013; Boisjoly et al., 2020; Kesimli & Günay, 2011), Control Environment (Kinyua et al., 2015; Liu et al., 2019; PHAM, 2021) and financial performance (Akintimehin et al., 2019; Nguyen et al., 2021; Nwanji et al., 2020). However, effect of the working capital with CE on FP has not been examined, so this study is going to fill this literature gap. This study is conducted on cloth and garments textile sector SMEs which plays an instrumental role in the Pakistan economy. It brings an increase in the ratio of employment generation and assists in the utilization of local resources for production at SMEs level. Having an access to local resources with little capital that assists people to engage in SMEs business, it brings them across entrepreneurial

opportunities (Leo, 2011). With the progress of SMEs, import of explicit things gradually decreases while the local making of such things gets supported.

## LITERATURE REVIEW

WC is an essential asset to meet the daily working charges, therefore, an appropriate method of the executives of WC is a key to guarantee a strong soundness of financial position to the organization. In this way, WCM plays a vital part in the returns of an organization (Jose et al., 1996) as shown in Figure 1 that how it effect financial performance. Therefore, a large competition among different organizations is currently mandatory to feel concern for WC. WC is the asset that an organization has in their CR. Now a days, in critical times when there is a large competition where each organization competes each other to increase their creation and deals, having of sufficient CR has become essential as CR incorporates reserves and raw materials which are needed for good and continuous creation. (Reddy & Gowtham). The underlying idea of WC was to make sure that a firm can achieve its momentary commitments in the form of performance. However, financial management's primary aim is to manage firms in a way that coordinates CRs with CLs (Fess, 1966). In addition to this, a decrease in a corporate movement brought about a financial emergency of 2008 ensuring waste of solvency of active consideration of researchers or an administrator that investigates by what means firms can deal with interest in a short resources or liabilities. Therefore, a demanding factor of reduced borrowing terms, increasing loan fees or a quick lessening output of an organization's items and its management brought about a collection of inventories. Thus, many organizations moved their concentration from development to improving inside proficiency and the board of their WC records (Aregbeyen, 2013). WCM assumes a significant part in an organization's productivity and danger of its worth (Smith, 1980). Therefore, there is a great deal of purposes behind the significance of WCM. In a regular collecting organization, CRs represent a portion of unconditional resources (SAGNER, 2001). For a progressing organization, CRs represent much more. Irrational degrees of CRs can be without large inflexibility of outcome in an organization's understanding of an unsatisfactory profit from businesses (Baker et al., 2017). No work around the globe happened in addition to money and WCM to manage the credit loss during the emergency time frame. It finds that an organization with a viable WCM practices carried out for a preferable duration of emergency regarding operations gained nothing (Kesimli & Günay, 2011).

In many studies, it was uncovered that CE particularly identifies the financial responsibility (Apollo, 2020; Mugo, 2013). Internal control including CE overall plans to improve FP value by means of the immediate or round about upgrade of data supplier responsibility (Njiru, 2016). Thus, the reason for IC is more extensive whereby issues with it can cause low incomes demonstrating relationship between material shortcoming acknowledgement and misrepresentation. By taking under consideration IC repetitions and profit, the board autonomously evaluates administrative FP quality in carrying out their obligations towards producing better incomes (Njeri, 2014). As indicated, the degree of a given IC framework's adequacy is identified with the organization's accomplishment in satisfying its focused-on income (Rapani & Malim, 2020). It involves steady surveys of the honesty and dependability of working and monetary data, the controls for protecting organization resources, just as the worker's loyalty to the executive's arrangements, techniques and appropriate laws and guidelines through which the administration satisfies organization targets (Rapani & Malim, 2020). IC is arranged as a preventive, criminal investigator or corrective. Preventive controls involve the forecasts of issues preceding their real event subsequently considering acclimations to keep away from the event of mistakes, exclusions or fakes. Analyst controls involve the recognition and detailing events of exclusions, blunders or cheats. Corrective controls involve

the declaration that puts the organization under risks, and their effects are moderated by distinguishing and adjusting issues. These Issues are recognized by criminal investigator controls and adjusted by the corrective controls in order to reduce future prospects of comparative events (Singleton et al., 2006). The internal CE incorporates an organization carried out rules, arrangements and measurements that convey top to bottom declaration: an association's FP reports are trustworthy, its activities are successful and capable and every single one of its exercises adjust to legitimate laws and guidelines (Tunji, 2013). It thinks that the variables connecting to the CE is comprised of the reliability, moral qualities, capability of workers and the board, the executives' convictions and functional style, the strategy in which authority and obligation are appropriated, the firm and development of representatives, and the commitment and pattern of the governing body towards hierarchical achievement (Bates, 2019). The CE begins with the directorate and the board, which controls the superiority of an organization through arrangements, practices and real administration (Karagiorgos et al., 2011). Assuming that the mentality set by the executives is careless then, at that point, deceitful monetary detailing and execution is bound to happen. CE is the key element of dealing with grounds of organization that is a thought of the influence and the approaches of the board in regard with the meaning of interior review in the financial unit. It has a control over association objectives accomplishment. Be that as it may, it is the reason for different instruments of inward control and giving design (Sudsomboon & Ussahawanitchakit, 2009).

## Hypothesis Development

WCM includes choice about organization CAs and CLs, just as deciding the source of money, regarding what they comprise of, what they are utilized for and how their mix means to the danger against the return attributes of the organization (Smith, 1980). It clarifies that how WC can be figured out to finance C/A as a financial investor in WCI, choosing the proper CLs as a temporary source of finance (Altaf & Ahmad, 2019). Accomplishing the necessary agreement between temporary means of finance and short-term interests in CA, it will be a genuine test challenging proficient financial heads to keep away from dissolvability/deficit and to expand profitability. A large portion of the recent studies confirmed the way that WCM strategy affects the FP of SMEs (Baños-Caballero et al., 2019).

### **H1:** *WC policy has a relationship with FP.*

A special firm activity with its current and future functioning expenses through its management of WC includes inventories, cash due, loan boss liabilities, and cash. In the standard sense, WCM is the limit that incorporates practical and profitable use of the huge number of parts of CAs and CLs to limit total cost (Moussa, 2019). Significant sections of WC are Debtors, Creditors, Cash, and Inventory (Sensini, 2020). It deals with the fact that volume can be expanded by large stock level and great proficient credit strategy. Stock is additionally the fundamental piece of the functioning money to satisfy the interest of public (Baños-Caballero et al., 2010; Padachi, 2006). Another part of WC is Accounts Payable/Short term borrowings. One can check the dishonor of a firm through reimbursement history and time to take care of organization's obligations. Record Receivable is additionally named as significant piece of WC (García-Teruel & Martínez-Solano, 2007).

### **H2:** *Managing WC components has a relationship with FP.*

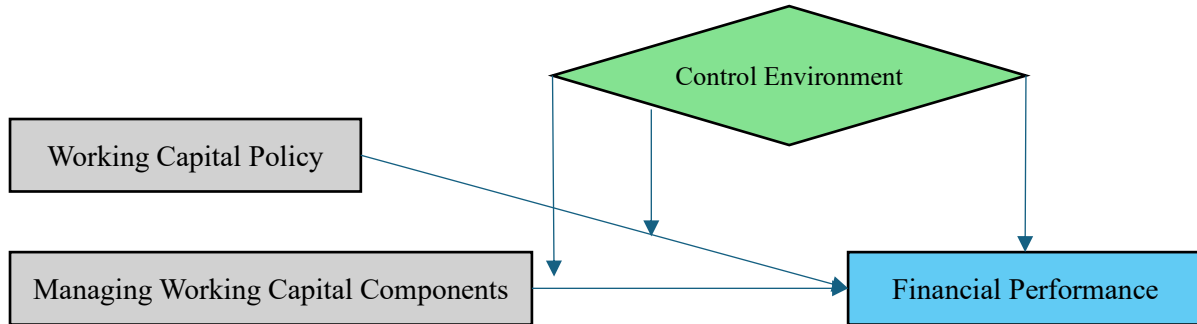
Considering that the management activities of each and every component of WC (Accounts Receivables, Accounts Payables, and Inventory) can impact benefit, this study plans to research the connection between every component of WC and CE in SMEs (Altaf & Ahmad, 2019; García-Teruel & Martínez-Solano, 2007). The environment of an organization matters a lot, since it is the authoritative tone, which influences control mindfulness, and gives sound

grounds to a functioning arrangement of internal control (IC). CE is the design and order, which guarantees the internal control points (Aksoy & Mohammed, 2020). Also, the CE recreates the board's adherence to IC by chiefs and executives and gives the control framework consistency and design (Senellart et al., 2017). In any case, CE makes a critical consciousness of IC to be set up and kept up by the organization and labor force of an organization. Respectability and moral qualities should be seen inside all staffs beginning from the top administration to the least representative (Hevesi, 2005).

**H2:** *CE has a relationship with FP.*

**H4:** *CE moderates the relationship between WC policy and FP.*

**H5:** *CE moderates the relationship between managing WC components and FP.*



**Figure 1:** Theoretical Framework.

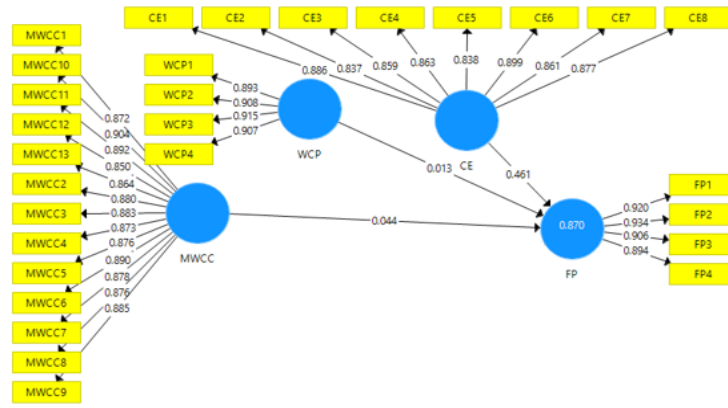
## METHODOLOGY

The current study deals with the quantitative examination method that is used to expose the structural relationship between proposed financial variables. The cross-sectional research design is selected in current study under which the data was collected one time only. Instead of longitudinal research approach design (based on resource contains such as time and money) the current study adopted cross-sectional design. As the current study respondents are on managerial positions and owners of SMEs in textile sector of Pakistan, therefore, the unit of analysis is individual. Current study population depends on the wide area. To cover the whole population, area cluster sampling is the most important or cost-effective technique. Furthermore, the sample size of this study is 384. Scale items for WC policy and WC components are adapted from literature (Belt & Smith, 199). For moderating variable CE, scale items are adopted from literature (Janet Cheptoo Bettl, 2017). For dependent variable FP, scale items are adopted from popular study from literature (Maignan, I., Ferrell, O.C., Hult, G.T.M., 1999). To determine the relationship between variables, measurement scale is one of the suitable scale ways. The current study is examining the relationship of WC on FP of SMEs in Punjab Pakistan. Therefore, scale instruments are one of the suitable methods to check that relationship. In this study questionnaire is adopted from the previous studies. Therefore, for WC (Independent variables) WC policy, and managing WC components scale items are adapted from literature (Belt & Smith, 1991).

## DATA ANALYSIS

As it has been indicated by literature (Hair et al., 2011; Joe F Hair et al., 2012; Henseler & Chin, 2010) that for assessment measurement model, researchers need to examine individual item reliability, ascertain internal item consistency, and discover convergent validity and discriminant validity. The researchers have additionally given a dependable guideline to hold the items whereby they have encouraged to hold items somewhere in the range of .40 and .70 (Hair Jr et al., 2014). PLS model is given in Figure 2.





**Figure 2:** PLS Model.

Reliability and validity results are given in Table 1. Factor loadings, composite reliability and AVE are higher than 0.5, 0.7 and 0.5, respectively (Hussain & Shafiq, 2023; Nazeer et al., 2024; Razzaq & Hamzah, 2023; Shehzad et al., 2020; Shehzad et al., 2019). Discriminant validity is characterized as the degree to which a particular latent constructs is not the same as the other latent constructs (Duarte & Raposo, 2010). The current study has used HTMT 0.90 criterion and has established discriminant validity by HTMT ratios which are always equal or below 0.90. The present study has suggested that the HTMT value of each latent construct is less than 0.9. Therefore, the current study gives the adequate value of discriminant validity as shown in Table 2.

**Table 1:** Factor Loadings, Composite Reliability and AVE.

Latent constructs and indicators	Standardized Loadings	Average Variance Extracted (AVE)	Composite Reliability (CR)
CE1	0.886	0.888	0.677
CE2	0.837		
CE3	0.859		
CE4	0.863		
CE5	0.838		
CE6	0.899		
CE7	0.861		
CE8	0.877		
FP1	0.92	0.821	0.555
FP2	0.934		
FP3	0.906		
FP4	0.894		
MWCC1	0.872	0.781	0.509
MWCC10	0.904		
MWCC11	0.892		
MWCC12	0.85		
MWCC13	0.864		
MWCC2	0.88		
MWCC3	0.883		
MWCC4	0.873		
MWCC5	0.876		
MWCC6	0.89		
MWCC7	0.878		
MWCC8	0.876		
MWCC9	0.885		
WCP1	0.893	0.872	0.524
WCP2	0.908		
WCP3	0.915		
WCP4	0.907		

Note: WCP = Working Capital Policy; MWCC = Managing Working Capital Components; CE = Control Environment; FP = Financial Performance

**Table 2:** Latent variable correlations and (HTMT).

	CE	FP	MWCC	WCP
CE				
FP	0.774			
MWCC	0.565	0.779		
WCP	0.565	0.456	0.555	

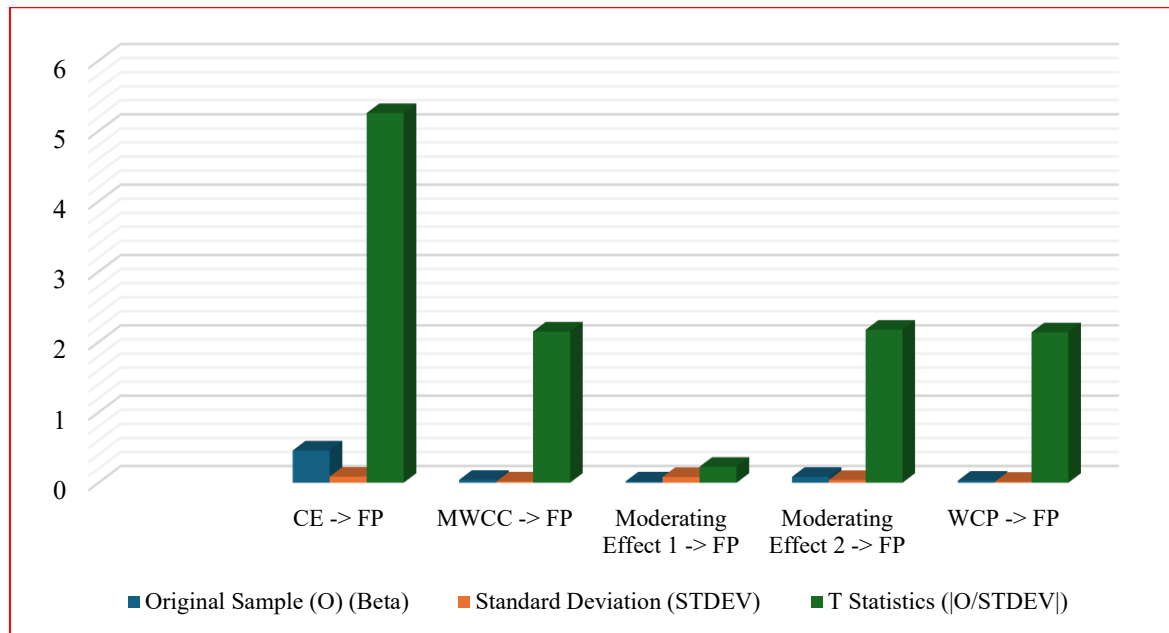
Note: WCP = Working Capital Policy; MWCC = Managing Working Capital Components; CE = Control Environment; FP = Financial Performance

After determining the measurement model, the current study has evaluated the structural model. This was done by the famous researchers in their recent studies by following the rules given in literature (Hair et al., 2011; Joseph F Hair et al., 2012; Hair Jr et al., 2014; Henseler & Chin, 2010). Results are reported in Table 3 which highlighted that one hypothesis is not supported, all others are supported. These results are also reported in Figure 3.

**Table 3:** Structural Model Assessment with Moderator Variable Results.

Relationship	Original Sample (O) (Beta)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values	Decision
CE -> FP	0.459	0.46	0.087	5.257	0	Supported
MWCC -> FP	0.041	0.045	0.019	2.151	0.032	Supported
Moderating Effect 1 -> FP	0.019	0.015	0.082	0.228	0.82	Not Supported
Moderating Effect 2 -> FP	0.084	0.085	0.039	2.176	0.03	Supported
WCP -> FP	0.03	0.032	0.014	2.139	0.033	Supported

Note: WCP = Working Capital Policy; MWCC = Managing Working Capital Components; CE = Control Environment; FP = Financial Performance



**Figure 3:** Results of Hypotheses.

Note: WCP = Working Capital Policy; MWCC = Managing Working Capital Components; CE = Control Environment; FP = Financial Performance

## DISCUSSION AND CONCLUSION

Numerous heads presently considered WCM as a deliberately significant, which may be an origin of a better hand to the firm (Yucel & Kurt, 2002). WC is one of the standards of monetary education. The analyst recognizes the liquidity level as a key factor for organizations suffering with disappointment or insolvency particularly under a financial downturn climate. It is normal for economical monetary managements to take a try at a sensitive agreement between

momentary resources and commitments by picking the perfect measure of interest in WC. Ideal WC assists with getting a compromise and firm worth among hazard (Haron & Nomran, 2016). There are three standards i: e capital construction, capital planning, and WCM in which corporate money discipline depends. Capital design and capital planning which accumulates more consideration of monetary experts in contrast with WCM and an impressive enormous proportion of corporate account literature comprises of these two-stream (Moussa, 2019). WC has been ignored in both observational and theoretical literature. Generally, WC is an asset report thing which actually adds to the investor's wealth extension (Kwenda, 2014). All the literature with respect to WC, mostly talks about its effect on FP less and relates that factor which characterizes firm's conduct of WC (Rehman et al., 2017). The monetary administration objective does not wind up with deciding the ideal degree of WC and its parts yet in addition it distinguishes the variables to the degree which can impact WCM (Moussa, 2019). Monetary literature partitions the determinant of WCM into three classes: i) Firms explicit factor ii) industry factor iii) macrocosmic variables. The determinant of WC varies with the period, industry's nature and macroeconomic condition (Boisjoly et al., 2020). Experimentally demonstrated that the effect of financial condition, mechanical factor, and firm-explicit elements vary from one industry to another.

The significance of WC increments, particularly in arising economies, under creating financial aspects of regular firms are small size and under the developing stage. Additionally, it has restricted access to the capital market, besides practically identical high-loan cost, poor lead representative component, political insecurity, and underdevelopment formal monetary strategies. These are qualities of creating economies that make it more testing to distinguish the ideal degree of working (Çetenak et al., 2017). Pakistan is a creating economy, so the WC strategy is essential for the durability of Pakistani firms. CE factors include: Integrity and moral qualities; the obligation to skill; initiative way of working style in a manner in which the board gives authority and responsibility by putting together its people (Kinyua et al., 2015). It is the proportion of achievement accomplished by an individual, group, firm, or cycle. Therefore, controlled environment increases different elements of IC frameworks (Chan et al., 2020). As indicated by Schaefer et al (2010) supervisors and inside reviewers, it is essential to realize the situation with the elements at the base (CE), not to transform them, but rather to consider their effect on the other control parts that affect the financial obligations. Furthermore, the current audit has potentially reviewed CE as a hypothetical facilitator of the relationship between exogenous and endogenous factors. The proposed framework of the current study has potentially super-sized the agency and contingency hypothesis by analyzing the effect of CE on the associations between WCM practices, its estimation and FP.

## LIMITATIONS AND FUTURE DIRECTIONS

Along with the strong results provided in the present study, the maintained great number of observations was important to interpret those findings in accordance with the restrictions of the study. Initially, a cross-sectional plan was aimed at, but easy-going inductions from the population were unrealistic. In this manner, the future researcher may consider a longitudinal plan to test the hypothetical group of the constructs throughout a more extended timeframe for responsive declaration of the hypothesized connections of the present study. Moreover, it is very hard to offer generalizability of the outcomes for the current study, as the example of the examination was predominantly determined from cloth and garments textile sector SMEs Punjab, Pakistan. Thus, it will be suitable that future researchers include other SMEs sectors in their study for better generalization of the findings. Other than that, the current study has only taken data from textile sector SMEs in Punjab, Pakistan. The future researchers may collect data from all over the Pakistan and other countries.



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