

Article Type: Original Article

Strategic Threads: Exploring the Interplay between Working Capital Strategies and Financial Performance

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Received: 25-02-2023, Revised: 19-10-2023, Accepted: 21-10-2023

ABSTRACT

Working capital management (WCM) helps organizations with consuming resources, helping organizations with keeping up sufficient cash flow to meet short-term targets and duties. However, companies related to the textile sector of Pakistan are facing the problem of WCM. Despite the improvement in WCM, the companies are facing challenges. The current study examined the role of WCM in financial performance of Pakistani textile companies. Population of the study is SMEs of Pakistan. Questionnaires were used for data collection. To apply cluster sampling, area is divided into provinces, after that the study selected few clusters randomly and the data was collected randomly from all the selected clusters. Smart PLS was used for data analysis. It is found that working capital policy and working capital managing overall has a positive role in enhancing financial performance. Furthermore, controlling the environment plays a moderating role in enhancing financial performance.

Keywords: Working Capital Management, Working Capital Policy, Control Environment, Financial Performance, SMEs, 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 3: Issue 1

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How to Cite: Ahmad, W. (2023). Strategic Threads: Exploring the Interplay between Working Capital Strategies and Financial Performance. *Int. J. Contemp. Bus. Lit.* 3(1), 35-43.

INTRODUCTION

Financial performance (FP) has been characterized as a bookkeeping based estimation on actions productivity of the firm through monetary proportions like profit from resources, return on sale growth and profit growth (Venkatraman, 1989), while literature (Zahra & Garvis, 2000) adds another monetary proportion as profit. Utilization of financial performance (FP) markers is an unavoidable practice which incorporates different measures to quantify FP (Venkatraman, 1989). It is proposed that proprietors and the administrators should concentrate on financial measures like benefit, income, ROI, return on sale growth and profit growth development in deals and productivity should be incorporated as markers of FP of Textile sector SMEs (Richard et al., 2009). It lays focus to deal with development and more significant indicators for estimating FP, which further comprises a significant piece of large business execution of firms. In the business world, the FP level has been founded on a portion of the significant management capacities like producing WCM activities (Hart, 1992).

Generally, working capital management (WCM) is a process of managing liquid resources of a specific business. FP is the degree to which monetary targets are being or have been achieved. It involves the estimation interaction of the cash related results of an organization's arrangements and tasks (Aktas et al., 2015; Baños-Caballero et al., 2012; Tauringana & Afrifa, 2013). Therefore, FP suggests the ability of an organization in gathering its monetary objectives. FP is assessed by two key indicators, specifically by its investor's profits and bookkeeping returns. The estimation of the former depends on the investors' viewpoint while the latter depends on the organization's income in light of various organizational approaches (Ganyam & Ivungu, 2019). FP gives an estimation about an organization's monetary standing over a specific period of time. So, it involves the monetary demonstrations of producing more important deals, benefit, and an incentive for the investors through the supervision of the organization's current and non-current resources, financing, value, incomes and costs. It gives monetary data to investors and partners that would permit them to settle on instructed investment decisions. FP information can be used to survey organizations that are indistinguishable or to make a comparison between industries (Rapani & Malim, 2020). FP indicates how much monetary targets of the firm have been accomplished (Fullerton & Wempe, 2009; Huselid, 1995). FP is a beneficial part of the organization's monetary which if not stable endangers the board that assists with estimating the aftereffects of organization's approaches tasks in financial terms. Therefore, it expands the requirement to measure in general the organization's monetary source, so it can raise the requirement for assessment of FP (Lappalainen & Niskanen, 2012).

The term WC can be indicated as trading capital which won't hold in any business in a specific structure more than a specific year. The working capital (WC) is utilized by any firm to meet its momentary economic fundamentals. WCM changes from one business to another or the interest in WC changes because of business activities. The need to keep an impressive WC can generally be valid for strong business (Anton & Afloarei Nucu, 2021). It is assessed that a successful management of WC may have a more intelligent effect on benefit of SMEs than on the large organization's execution, since a lot of the absolute resources of SME firm begin from the sizeable CA's and oversaw CL's. This study has direction for the clear WC board power guideline on the validity of SME area firms in Pakistan. Results show that the WCM generously affects the performance of the SME measured firms (Afeef, 2011). WC is an important part of the organization because it needs capital for its daily consumption. Many organizations fail every year because of ineffective WCM practices (Peel & Wilson, 1996). Great WCM exposes more remarkable capitulate of CR's than the CL's to keep a conformable wealth rank of an organization (Afeef, 2011; Ibrahim et al., 2021).

This study has a major significance in understanding the WC with control environment (CE) impact on FP as we know the WCM includes keeping up the WC working cycle and ensuring its organized activity, prevent the expense of capital consumed on WC and increasing the profit from CR theory. WCM comprises volume assurance and asset mix. The WC utilization causes the investors resources and FP to expand and then the investors take more investment decisions to get high returns. When there are more investment decisions in different projects, then it creates job opportunities which helps to reduce unemployment. So, this study will contribute in suggesting that WC with CE has a positive impact on FP (Boisjoly et al., 2020).

LITERATURE REVIEW

A financial measure called the working capital is clarified by subtracting the current liabilities from the current assets (Deloof, 2003; Iftikhar, 2013; Nastiti et al., 2019; Semaa et al., 2020). When a corporation has the positive working capital, it can make investments to support business expansion and pay its debts (Boisjoly et al., 2020; Ghosh & Maji, 2004; Mohamad & Saad, 2010; Mukhopadhyay, 2004). CE contributes towards diminishing the level false exercises inside authoritative activity, likewise the worth of an element's interior controls framework is dependent upon the reason and worth of their CE (Amudo & Inanga, 2009). Therefore, giving a proper CE for a neighborhood government is exceptionally essential to the proficiency of their activity. This large number of exercises help the board and the executives control hazards that could challengingly influence the organization's activities and results (Colbert, 1996). The strategies that direct these control exercises ought to likewise give that the organization faculty which is answerable for these control exercises doesn't assess their own work in these regions. Study farmwork is reported in Figure 1.

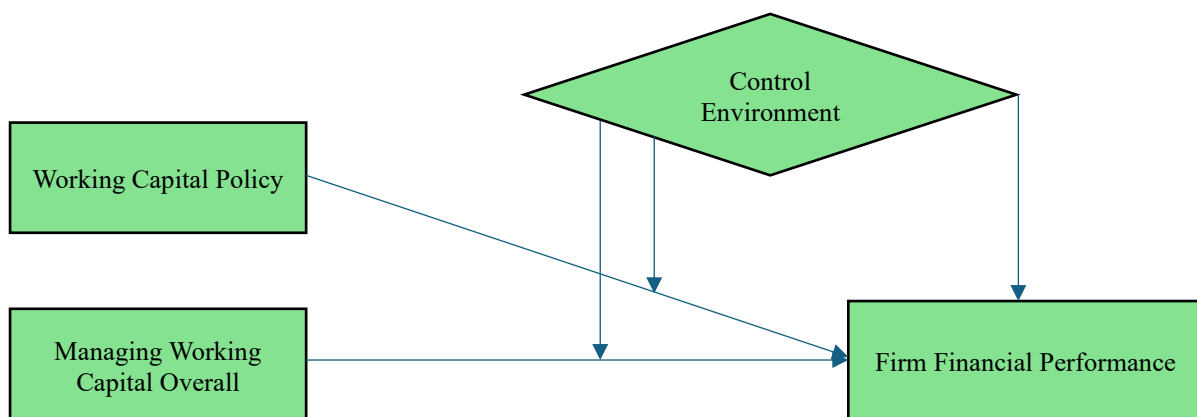


Figure 1: Framework of the Study.

WCM helps organizations with consuming CR, helping organizations with keeping up sufficient cash flow to meet short-term targets and duties (Nastiti et al., 2019). This is calculated by the effective management of accounts payable, accounts receivable, inventory and cash of SMEs (Iftikhar, 2013). WCM respects all tasks that affect CRs and CLs of SMEs (Raheman & Nasr, 2007; Sensini, 2020). Efficient WCM addresses a significant part of monetary management approaches that requires the capacity to examine a company's present resources and liabilities to meet temporary commitments while restricting the useless interests in financial resources (Van Horne & Wachowicz, 2004). Beginning from the original paper of (Smith, 1980), which have proposed that handling short-term resources and liabilities are important since it affects organizations' benefit, hazard and worth. There are numerous different commitments in this field and a lot of the studies emphasized the significance that WCM has on financial suitability and corporate strength of SMEs (Baños-Caballero et al., 2019; Nazir & Afza, 2009; Shin & Soenen, 1998). In this viewpoint, keeping an ideal stability among every component of the functioning

capital, it impacts the FP as well as the business achievement (Adekola et al., 2017). Therefore, whenever WCM is properly managed then it helps to improve the FP of SMEs (Abdulazeez et al., 2018). WCM assumes a significant part in administrative undertaking. It might have an effect on progress or disappointment of firm in business since WCM influences the productivity of the SMEs (Aminu & Zainudin, 2015). Therefore, WCM is a promotion power to firms (Abuzayed, 2012; Mukhopadhyay, 2004) and the proficient WCM is the pre-conditions for the financial achievement of an organization (Ghosh & Maji, 2004; Orobia et al., 2016). It demonstrates the most now and then performed schedules in overseeing WC which identifies how to protect money and stock, and credit hazard evaluation. However, a decrease in the inventories is dependent on the quantity of days that organizations take to settle their business liabilities and to gather instalments from its clients which are related to higher corporate benefit (Pais & Gama, 2015).

Inventory, cash due, the loan boss liabilities, and cash are cases of a unique corporate activity that the management of WC incurs both present and the future operational expenses. WCM, in conventional meaning, is the upper limit that considers lucrative and useful utilization of vast majority of CA and CL elements in order to restrict overall cost (Moussa, 2019). The Debtors, Creditors, Cash, and Inventory portions of WC are significant (Sensini, 2020). WCM plays a significant part in making progress. Great WCM will guarantee a firm great monetary essentials, which gives the capacity to adjust advertise changes, for example, variations in simple material costs and loan fees eventually permit them to struggle on the viewpoint (Dhole et al., 2019). WC management influences firms' liquidity as it identifies it with CR and CL (Adekola et al., 2017; Tran et al., 2017). The aftereffects of Annual Global Working Capital Survey 2019/2020 led by managements of enormous organizations in the US and Europe expressed that managements have focused closer on WC execution. In the event where financial manager accomplishes the stability between assigning investments in CA and financing WC is recognized as WC strategy (Altaf & Ahmad, 2019). Effective choice of WCM strategy will straight forwardly influence the firm's expense, hazard, manageability or increment in returns as carried out by many researchers (Peng & Zhou, 2019; Salehi et al., 2019). From the above discussion, hypotheses of the study are as follows;

Hypothesis 1: *WCP has a positive influence on FP.*

Hypothesis 2: *Managing WC overall has positive influence on FP.*

Hypothesis 3: *Control environment has a positive influence on FP.*

Hypothesis 4: *Control environment moderates the relationship between WCP and FP.*

Hypothesis 5: *Control environment moderates the relationship between Managing WC overall and FP.*

METHODOLOGY

Population of the study is SMEs of Pakistan. Questionnaires were used for data collection from the textile industry. To apply this technique of cluster sampling, the state is divided into provinces, then study will select few clusters randomly among the selected provinces and after that, the data will be collected randomly from all the selected clusters. As the current study is based on the province Punjab of Pakistan, therefore, sample size is based on all the cloth and garments textile sectors SMEs of Pakistan. According to the ‘‘International the News’’, there are almost 4.5 million SMEs working in Pakistan. According to literature (Morgan, 1970), population more than 100000 required sample size of 382. In the current study, our estimated sample size is taken as 1300. For moderating variable CE, scale items are adopted from literature (Janet Cheptoo Bett1, 2017). To measure WC policy and managing WC overall, scale items are also adapted from literature (Belt & Smith, 199). Four scale items were adopted from Samiee and Roth (1992) to measure financial performance.

This study is observing the relationship of WC on FP and moderating role of CE. The questionnaire comprises of four sections. The first section is based on demographic profile of respondents such as age, gender, highest education and occupation. The second section consists of the items of WC. The third section is comprised of the scale items of CE as a moderating variable respectively. The fourth section is contained with items identified with FP (dependent variable). This is comprised of 4 dimensions ROI, ROA, Sale growth and profit growth increments.

FINDINGS

The initial data screening is basic for data collected by using questionnaire which distinguishing any potential contravention of the basis uncertainties with respect to the utilization of multivariate techniques (Hair et al., 2006). It helps in proper investigation because it increase the accuracy (Hair et al., 2006). As per Coakes, S., & Steed, L. (2001), it help to maintain normality of the data. Furthermore, the current study has utilized a two-step measure for assessing and announcing PLS-SEM results (Henseler & Chin, 2010). All the items found factor loadings higher than 0.5 (Bijttebier et al., 2000; Sun et al., 2007). Alpha and CR are higher than 0.7 (Hussain & Shafiq, 2023; McCrae et al., 2011; Nazeer et al., 2024; Peterson & Kim, 2013). Factor loading, CR and AVE are given in Table 1. Discriminant validity is given in Table 2.

Table 1: Factor Loadings, Composite Reliability and AVE.

Latent Constructs and Indicators	Standardized Loadings	Composite Reliability (CR)	AVE
CE1	0.856	0.709	0.596
CE2	0.737		
CE3	0.759		
CE4	0.8		
CE5	0.788		
CE6	0.809		
CE7	0.821		
CE8	0.777		
FP1	0.82	0.735	0.503
FP2	0.884		
FP3	0.776		
FP4	0.752		
MWCO1	0.801	0.804	0.558
MWCO2	0.805		
MWCO3	0.875		
MWCO4	0.899		
MWCO5	0.821		
MWCO6	0.852		
WCP1	0.802	0.882	0.908
WCP2	0.911		
WCP3	0.715		
WCP4	0.707		

Note: WCP=Working Capital Policy, MWCO=Managing Working Capital Overall, CE=Control Environment, FP=Financial Performance

Table 2: HTMT.

	CE	FP	MWCO	WCP
CE				
FP	0.562			
MWCO	0.542	0.779		
WCP	0.621	0.668	0.632	

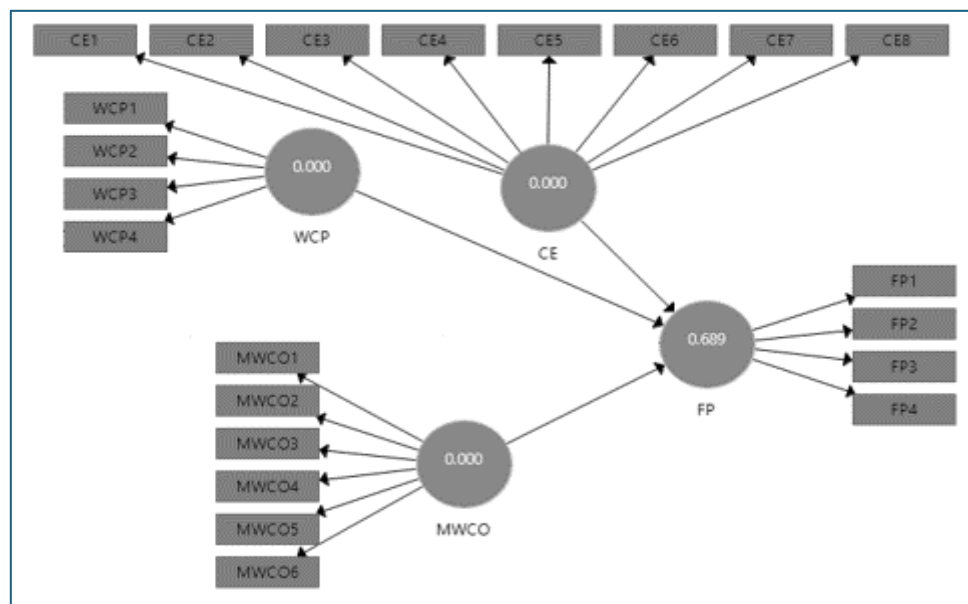
Note: WCP=Working Capital Policy, MWCO=Managing Working Capital Overall, CE=Control Environment, FP=Financial Performance

Results are reported in Table 3. One hypothesis is not supported because the t-value is less than 1.96, all others are supported. PLS-SEM Assessment of Structural Model suggests a significant rule; the R² value evaluation. The R² is called coefficient which is also called beta (Hair et al., 2011; Hair et al., 2012; Henseler & Chin, 2010). The R² value addresses the extent of changes in the endogenous variable(s) (Elliott & Woodward, 2007; Hair et al., 2006; Hair et al., 2011). In this study, R² is moderate. As indicated the Q² is an action that tells how fine a model predicts the information of excluded cases (Chin, 1998; Hair Jr et al., 2014). Predictive Relevance (Q²) given in Figure 2. is higher than zero, which confirmed the quality of the model.

Table 3: Results.

Relationship	Original Sample (O) (Beta)	T Statistics (O/STDEV)	P Values	Decision
CE -> FP	0.558	5.257	0.000	Supported
MWCO -> FP	0.204	2.15	0.031	Supported
Moderating Effect 1 -> FP	0.009	0.128	0.92	Not Supported
Moderating Effect 2 -> FP	0.093	2.176	0.03	Supported
WCP -> FP	0.053	2.138	0.032	Supported

Note: WCP=Working Capital Policy, MWCO=Managing Working Capital Overall, CE=Control Environment, FP=Financial Performance



Note: WCP=Working Capital Policy, MWCO=Managing Working Capital Overall, CE=Control Environment, FP=Financial Performance

Figure 2: Predictive Relevance (Q²).

CONCLUSION

The framework of this study has been drawn on the base of experimental confirmations and research academic gaps as described in literature. Benefit and clarification for the structure has been drawn according to two theoretical points of view i.e., Agency theory and Contingency theory. In this current study, the CE is used as a moderating variable to more likely realize and clarify the relationships between WC, its measurements and FP. The results show that WCP has significant impact on FP of SMEs and my results have also matched with the previous studies. It suggests that WCP is an important element for better FP of SMEs in current study. Furthermore, results of current study have confirmed the WCP importance in good FP of companies. Furthermore, this study confirmed a major connection between MWCO and FP of SMEs. This suggests that if the MWCO of an organization is efficiently managed, then it leads towards the effective FP of an organization in the current study. Additionally, results show that CE has a positive impact on FP.

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