Working Capital Strategy and Working Capital Management: Impact on Profitability

Ankit Nijhawan [1]

[1] Student, Department of Management, Symbiosis Institute of Management Studies, Pune (Affiliated to Symbiosis International Deemed University)

ABSTRACT

This study aims to check the consequences of the Working Capital Management (WCM) and the Working Capital Strategy (WCS) on the results of organizations over the various phases of the Corporate Life Cycle (CLC). Overall, there is a negative corelation between WCM and such results. However, it is not consistent throughout the various phases of the life cycle of an organization. For instance, such negative correlation is more likely to be prominent at the start-up stage of an organisation, while it rarely has any major effect on the output of mature firms. Likewise, WCS also has a variety of distinct impacts on financial results around the CLC. Secondary approach was carried out to pursue the study and theoretical review was carried out.

However, the life-cycle stage is rarely taken into consideration while formulating the WCM approach by the management of most organizations. This might significantly threaten their financial sustainability. These indicate that companies need tailored WCM and WCS to achieve sustainable financial efficiency during the various stages of the organisations life cycle. The decision makers should likewise not disregard the fundamental situation of the CLC stages in their planning to guarantee success.

Keywords

working capital, management, financial sector, profitability

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Introduction

Working capital is the firm's balance in existing assets against total liabilities, and serves to calculate the degree to which a corporate may cover the growth in revenue from other reserves in funding for its day-to-day activities. Working capital is the mathematical disparity of two aggregated balance sheet accounts, i.e. Current assets and liabilities. WCM is concerned with the funding, allocation and regulation of net current assets within the policy framework. Working capital can be seen as the lifeblood of a company, and its maximum and sound supply will boost the corporate' growth capacity.

WCM is a significant consideration for any corporate as it directly impacts the viability of such corporate. The company can maximize its efficiency and profitability when working on a regular basis. Profitability can be maximised by maintain this capital close to the ideal levels. Proper management of resources requires reducing the need for working capital and generating the highest potential sales.

The goal of the management with respect to working capital is to guarantee that the its operational costs are covered, thus, it can fulfil its commitments in the short run. Mismanagement of working capital will contribute to a liquidity shortage and a decline in profitability. Typically, capital management consists of preparation and allocation of existing assets and obligations in a manner that reduces the possibility of impacting short-term demands and prevents undue spending.

Operating efficiency and financial stability are two main elements in the overall management of any company. Operating liquidity applies to the equilibrium of capital as cash or as assets which can be converted into cash (current assets) and those liabilities which require settlement in the short run (current liabilities). Debt is the arrangement between the assets and the equity of the capital structure which contains loans, equity capital and preference capital. Through this, the organisation can fund its capital assets, activities and financial development.

Working Capital Management and Corporate Life Cycle

WCM harbours an important position in stabilization of an organisations finances as it can directly impact company funding, performance and solvency. This capital has the following components- inventories, accounts receivable, cash , and accounts payable The management of cash is concerned with the sum needed to fulfil

daily corporate requirements while reducing the expense of maintaining a large reserve of cash. Greater levels of inventory are often correlated with high revenue rates and less transaction costs, thereby increasing profits. On the other hand, such inflated stock levels could raise the risk of commodity depletion, excess storage costs and premiums to insure the same against the various risks.

At the same time, maintaining stock levels at the bare minimum requirement levels increases the risk of running out of stock and, ultimately, the losing out on potential customers. Money owed to an organisation is referred to as "accounts receivable." A company's inventory-receivables turnover ratio measures how quickly it receives this money that it is owed. An organisation allowing its customers more time to pay these sums do witness an increase in the volume of sales and hence improve its profitability.

However, a prolonged span of time could also raise the firm's debt level, which could contribute to an increased strain on financing costs. Inventory payables turnover is the time between delivery of products and the transfer of cash to the supplier.

However, lengthy gaps in the purchaser's payment process can have detrimental implications for the supplier Bearing in mind that the optimum control over such constituents is perceived to impact the performance, liquidity, solvency, riskiness and valuation of the organisation.

To achieve efficiency within a dynamic organisational climate, managing working capital efficiently is necessary for companies of all sizes operating in different corners of the globe. However, the management of such capital is of greater significance to corporates working in growing and developed nations. These companies are typically small in scale as compared to others and have restricted access to financing from outside the organisation, they depend primarily on internal funding services, industrial loans and term loans for with a short duration in order to fund its current capital requirements. Corporate life cycle is still an alien concept for many corporates. Companies could progress over the various stages of this cycle, where technical and market factors play a major role in bringing about company development. More specifically, CLC implies that organisations are like beings that progress through repetitive stages of their lives and their energy, composition, policies and capital needs differ dramatically during each point of growth.

At the start-up point, companies need greater spending in capital assets to render the corporate less competitive to potential entrants. New companies typically have total capital outflows with comparatively poor income and greater probability of bankruptcy. However, the key factor that hinders development during the company's introductory process is minimal internal financing.

Moreover, owing to higher knowledge asymmetry, start-up companies face a lack of external funding. Thus, the owners of such companies prefer to raise foreign resources at higher interest rates. Mature companies are distinguished through the growth in volumes, distinctiveness of their expertise and a product line which is diversified. At this stage there is more dependence upon foreign funding on account of greater demand for capital as compared to the capacity to raise funds from within the organisation.

Even so, in relative comparison to start-ups, the expense of venture funding and the possibility of bankruptcies is lower for mature companies. The advanced stage of a company's corporate cycle is ongoing as market development starts to slow down. At this point, revenue levels are stabilizing and companies are reasonably cautious, choosing to maintain what they have accomplished. While mature companies can borrow at lower rates, demand for external funding is diminishing significantly as the flow of cash produced from internally from operations are adequate to satisfy financial requirements. The stage of decline in CLC is marked through a reduction in earnings due to a drop in market value. To address this challenge, companies have to increase spending in order to promote demand in an effort to recover market share. They also need to spend more on Research and Development in order to stay competitive and relevant. In addition, shrinking companies with high debt ratios pose an elevated likelihood of bankruptcies.

Studies further claim that the stage of the life cycle has significant effect on the financial efficiency, funding, acquisition and danger of bankruptcy. In addition, any transition in the life-cycle process often impacts the financial stability of an organization and thus impacts its access to foreign financial services. For example, lenders

are hesitant to commit funds to a financially troubled company. And if they make such a commitment, it bears a higher rate of interest, resulting in further deterioration of the firm's efficiency.

Working Capital Strategy and Corporate Life Cycle

Numerous reports exist on the partnership between the Work Capital Strategy (WCS) and the results of an organisation. Some of these show vigorous WCS is best adapted to improve the financial soundness of a company. Some contend that a cautious WCS would allow companies to raise their turnover volumes and grow their market share, which would eventually improve profitability. Holding these clashing perspectives in context, we propose that the CLC stages can assume a significant part in settling this issue by recommending which technique is generally suitable for which phase of the existence cycle to improve firm productivity, and as a consequence, to enhance long-term financial sustainability. At different stages in their life cycle, firms have varying capital requirements to build their monetary effectiveness. Firms have limited resources during Birth, Rise, and Decline phases, they therefore can follow vigorous WCS to maintain financial output.

On the other side, mature companies have ample funding to support new ventures because, in the sense of restricted prospective development opportunities, in the form of retained earnings, they have access to some extra cash. Thus, over-investment in WC does not have a major effect on company results for mature companies. Faff et al (2010). claim that procurement, funding and strategies for cash management are intertwined and adjust according to the stage of the life.

Similarly, Hasan and Habib argue that the life cycle process of corporates has a substantial effect on the acquisition and funding practices and the dividend payout strategy. WC is specifically related to the funding capacities of companies, and these skills are not identical at any level of the CLC. This relationship offers a strong foundation for the claim that the financial soundness, funding and related efficiency of companies vary with the shift in CLC.

Empirical studies are, however, not conclusive as there has not been enough focus on examining the function of the CLC stages and their effect on WCM and its relationship with the company's performance. The present research is seeking to fill this gap by establishing a correlation between WC theory and CLC. The objective of this paper is consequently to uncover the impact of WCM and WCS on firm monetary outcomes at each purpose of the corporate life cycle, which will adequately empower strategy producers to build up custom-made strategies for the particular CLC interaction to make economic progress throughout the long term.

REVIEW OF LITERATURE

Baños-Caballero et al. (2016) have demonstrated that there is an ideal degree of WC for each corporate and that up to that ideal degree of use in WC produces higher productivity.

In addition, **Enqvist et al. (2016)** discovered that the impact of the life cycle of the market on the WCM-execution connection is more significant during monetary plunges compared with financial expansions. Tsuruta and Economy note that Japanese organizations couldn't make changes to their WC after the 2008 worldwide monetary emergency. Likewise, the negative connection between overabundance WC and friends benefit has been more obvious all through the emergency period.

Bonazzi and Iotti (2015) studied the partnership between the funding measure and financial soundness of dairy companies within Italy. Study of the Standard flow of cash indicates that these companies face difficulties achieving sustainable results that may adversely impact financial resilience.

From the WCM point of view, **Njeri et al. (2017)** investigated the relationship between profitability, labour and the administration's capital resources government-possessed establishments in Kenya. The results of the analysis indicate WCM as a key component in determining the health of such companies. Nevertheless, it is uncertain how CLC impacts the relationship as analytical effort has not been made thus far to investigate effect of CLC transition on WCM and the organisation results. The CLC Hypothesis contends that organizations experience a grouping of expected development stages and that the arrangements, measures, hazard taking capacities of the organization contrast drastically with the change in their advancement cycle.

Shahadan and Saarani (2012) concluded that equity plays a crucial role in determining operational liquidity.

Palombini and Nakamura (2012) observed that companies with more debt usually have lower financial liquidity**.**

Naser et al. (2013) suggest that the financial flexibility of an organisation determines the operational liquidity.

Gill (2011) observed, flexibility in the manufacturing sector in Canada plays a significant role in assessing the degree of operational liquidity.

Nazir and. Afza (2009) claim that an organisation's economic efficiency is affected by the financial debt.

Zubairi (2011) investigated the impact of operational liquidity and capital construction on the productivity of automotive organizations in India and found that the two perspectives affected financial soundness.

Xin (2014) established a crucial relation between debt and the financial output.

Sheik and Wang (2013) were able to create an inverse relationship between firm efficiency and leverage. **Padachi (2006)** was able to form a relationship between efficiency and operational liquidity through her study of small manufacturing units in Mauritius.

Charitou et al. (2010) analyzed the corporatees listed on the Cyprus Stock Exchange and observed a connection between the viability of an organisation and the trading competitiveness. **Lazaridi and Tryfonidis (2006)** examined the firms listed on the Athens Stock Exchange and discovered an important association between the financial soundness and the liquidity status of the company.

Mansoori and Muhammad (2012) analysed few Singapore firms and found that effective management of working capital may contribute to more profits.

According to Margaretha (2007:219), the financial framework is the ongoing funding of the company comprising of long-term debt and cash. The capital structure is the proportion of the gross short-term debt that is secure, long-term debt, preferred stock and equity (Halim, 2007). Another concept of the capital structure is that the company's equity and debt funding is often counted as a means of finance on the basis of the relative quantity. The company's capital structure is determined by several variables, including interest rate, income level, asset composition, asset risk levels, overall capital needs, stock market status, management characteristics and company scale

However, research conducted indicated working capital having negligible effect on the profitability of the telecommunications sector. It is backed by research by **Sial et al (2012)** on the textile company in India that there is an important relation amongst the constituents of working capital and profitability.

Conclusion

This paper gives an insight into WCM and the firm efficiency connection according to the various stages of its life-cycle. We conclude that companies at different points of the life cycle have varying capital needs and their capacity to collect funds from outside the organisation tends to evolve around the CLC. Investment in WC accounts thus has varying consequences for success at different levels of the CLC. Empirical findings indicate that, regardless of the CLC level, higher levels of WC have adverse impact on the efficiency. However, more funds linked to WC at the launch, development and declining phases were observed to be correlated to weak results. This observation is compatible with the hypothesis that start-up companies are confronted with lack of financial resources due to knowledge asymmetry and challenges forecasting potential growth opportunities, so that corporates can access foreign capital at higher prices, and that over-investment in WC at these CLC stages will significantly impede organisation sustainability.

However, they will need increased funds to support fast-paced progress. Companies are often renowned for strong spending in a restructuring effort, but a non-diversified management strategy typically contributes to involvement in unfavourable NPV ventures culminating in a reduction in revenue and profit margins.

As a consequence, greater WC over the phases of the life cycle allows companies to borrow from external sources, which ultimately contributes to a downturn in organisation efficiency. In comparison, extra funds connected to WC do not substantially impact the output of established companies, which can be due to the presence of excess cash reserves and the good financial position of these corporates.

Furthermore, we additionally dissect the connection between WCS and the organisation output in accordance with the stage of life-cycle. It can be seen that cautious WCS affects organisation efficiency adversely. The findings at different stages of the Life cycle indicate that the success of start-up, growing and decreasing corporations is adversely related to a conservative approach. This means that the managers in these companies must pursue an ambitious WCM policy to maximize profits. In accordance with standards, the success of established companies and WCS has no major connection. All in all, our results demonstrate that companies need more tailored WCM and WCS to achieve reliable success financially at any stages of the corporate life cycle.

Particularly in developing economies, where financial sectors are immature and admittance to outside financing is confined, the determination of reasonable WCS comparable to the CLC stage will fundamentally assist these organizations with dealing with their monetary capital all the more judiciously for practical corporate turn of events. The discoveries of this exploration show a relationship between WCM and the monetary yield of the organization during the CLC stages and note that corporates require a customized WCS at each degree of CLC for maintainable monetary achievement.

In developing countries where companies face severe external funding restrictions, it is crucial to change WCS at every level of the CLC to ensure the sustainability of corporate operations. As a consequence, managers must not ignore the major impact of CLC in their financial decisions during the short term, as avoiding it will significantly threaten the financial survival of the corporate. In addition, investors and borrowers shall track the capacity of the company to successfully match its WCS with the stage of the life cycle to prevent engaging with companies having unstable corporate policies.

The findings of this analysis can only be applied to developed countries with a comparable level of economic growth. But, future research in this area will examine related relationships in the sense of developing countries. Furthermore, it would be important to observe macroeconomic influences and their impact, such as the market cycle and economic development, between WCM and sustainability of results.

IMPLICATIONS

The consequences of this examination show that twin monetary strategy choices encompassing working capital and financing choices are interlinked and should be attempted simultaneously with the goal for organizations to expand their benefit. For financial officers, this ensures that the judgment on organizational finance cannot be made unilaterally without proper regard of the structure of the working capital. On the off chance that, when settling on the alternative of monetary source, the hierarchy conjectures are to be followed, due consideration and assessment should be taken all together not to bargain the liquidity status of organizations, which would simply expose them to additional dangers.

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