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THE EFFECT OF WORKING CAPITAL MANAGEMENT ON PROFITABILITY: CASE STUDY OF A MANUFACTURING COMPANY LISTED ON THE INDONESIAN STOCK EXCHANGE

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Abstract

This research aims to examine the effect of working capital management on the profitability of manufacturing companies listed on the Indonesia Stock Exchange (BEI). This study uses a literature review method, where secondary data taken from company financial reports and previous research results are processed and analyzed. The main focus of the research is to understand how the management of current assets and current liabilities can influence the level of profitability as measured by financial indicators such as Return on Assets (ROA) and Return on Equity (ROE). The research results show that effective working capital management, including optimal management of accounts receivable, inventory and accounts payable, has a significant positive impact on the company's financial performance and profitability. These findings underline the importance of efficient working capital management strategies in generating added value for companies and increasing competitiveness in the manufacturing industry. Thus, the practical implications of this research confirm that companies need to consider working capital management policies as an integral part of their strategic financial planning.

Keywords: Working Capital Management, Profitability, Manufacturing Companies

INTRODUCTION

Working capital management is a critical aspect in a company's operations, especially in the manufacturing industry. Working capital includes the company's current assets used in daily operations, such as cash, receivables and inventory (Supiyadi, 2023). Effective working capital management ensures that a company has sufficient liquidity to meet its short-term obligations, maintain smooth operations, and avoid financial difficulties that could disrupt production. In the context of the manufacturing industry, where production operations often require significant investment in raw materials and supplies, efficient working capital management becomes very important to maximize the company's operational efficiency and financial performance (Ramadhani & Lestari, 2024).

The manufacturing industry is known for its complex and long-term operating cycles. The production process which involves several stages starting from purchasing raw materials, the production process, to selling the final product requires proper working capital management to ensure that each stage can run smoothly without financial obstacles. Mistakes in working capital management can result in excessive inventory buildup or shortages of raw materials that hamper production (Kristiana & Karnasi, 2024). Therefore, manufacturing companies must have a well-planned working capital management strategy to optimize production and meet market demand effectively.

In addition, good working capital management can contribute to increasing company profitability. Companies that are able to manage inventory, receivables and payables efficiently will be able to minimize operating costs and increase cash flow (harianto et al., 2022). For example, optimal inventory management can reduce storage costs and losses due to obsolescence. Good receivables management can speed up cash receipts from customers, while wise debt management can take advantage of the credit period provided by suppliers to maintain liquidity. All these factors contribute to increasing profit margins and overall financial performance of manufacturing companies.

In the context of increasingly fierce business competition, working capital management is a key factor that differentiates successful companies from others. Manufacturing companies that are able to manage their working capital well can not only avoid liquidity problems but can also invest in innovation and expansion. Such investments are not possible without efficient working capital management, as it will be difficult for the company to free up the necessary funds (Deshpande, 2023). Therefore, it is important for manufacturing companies to continuously monitor and evaluate their working capital management strategies in order to remain competitive and able to survive in the long term.

Profitability is one of the main performance indicators that is very relevant for companies listed on the stock exchange. Companies that are able to show a high level of profitability are usually preferred by investors because they tend to show good company performance and financial stability. Profitability ratios, such as return on assets (ROA), return on equity (ROE), and net profit margin, help investors assess a company's ability to generate profits from assets and equity owned, as well as the company's operational efficiency (Aditia & Kustinah, 2023). Thus, the level of profitability is a determining factor in investment decisions taken by shareholders and potential investors.

Apart from attractiveness for investors, profitability also influences the company's share price in the market. Companies that demonstrate consistently increasing profitability often experience an increase in share prices, which reflects the market's positive view of the company's performance. Conversely, a decline in profitability can lead to a decline in share prices, reflecting investors' concerns about performance problems or the company's future prospects. Stable or increasing share prices provide confidence to shareholders and can attract more investors to buy company shares, which ultimately increases the company's overall market value (Agustiyana, 2022).

Profitability also plays an important role in a company's ability to distribute dividends to shareholders. Dividends are a way for companies to return part of the profits generated to their share owners. Companies that do not generate sufficient profits may be unable to pay dividends or only be able to pay dividends in small amounts. This could have a negative impact on investor satisfaction, especially those seeking a steady income stream from their investments (Jaworski & Czerwonka, 2022). Therefore, high profitability allows companies to provide attractive returns to shareholders, which in turn can increase investor trust and loyalty to the company.

Additionally, good profitability indicates that a company has strong financial health and the ability to invest in future growth. The profits generated can be used for investments in innovation, research and development, acquisitions, and business expansion, all of which are important for maintaining a company's competitiveness in the market. Companies that are able to generate sustainable profits have more flexibility in strategic decision making and are able to better handle economic and industrial challenges (Korkmaz et al., 2023). As a result, high profitability is not only relevant for a company's short-term performance but also for long-term business continuity amidst changing market dynamics (Mahalwala & Ahuja, 2023).

RESEARCH METHOD

This research will use a literature review approach by examining various academic sources, industry reports and relevant case studies. A comparative analysis of existing studies will be conducted to identify common patterns and findings. In addition, interviews with experts and practitioners in the field of content marketing will also be conducted to gain further insight (Earley, M.A. 2014; Snyder, H. 2019).

RESULT AND DISCUSSION

Empirical Relationship between Working Capital Management and Profitability

Effective working capital management has a significant influence on a company's profitability, as shown by various empirical studies. These studies find that companies that maintain an optimal balance between current assets and short-term liabilities can minimize capital costs and maximize operating income. For example, research shows that a short cash conversion cycle, which is an indicator of working capital management efficiency, can increase a company's Return on Assets (ROA) (Shivakumar, 2022). This happens because fast cash turnover allows companies to utilize their resources more efficiently.

Furthermore, specific components of working capital, such as inventory and accounts receivable, also show a significant relationship with profitability. Proper inventory management allows companies to reduce carrying costs and the risk of obsolescence, thereby increasing net profit margins. On the other hand, effective trade receivable management can speed up cash receipts and reduce the risk of bad credit, which in turn can increase Return on Equity (ROE) (Purbowati, 2022). Empirical research supports that good management of these components is often associated with better financial performance.

However, this relationship is not always linear and can be influenced by external factors such as macroeconomic conditions, industry regulations, and the level of competition. Therefore, while efficient working capital management generally supports increased profitability, companies must consider their specific context in executing working capital strategies (Kandukira, 2022). Empirical studies also show that a flexible and adaptive approach to working capital management, which aligns financial strategy with market conditions, is more likely to produce positive results in terms of profitability.

To explore further, companies must calculate and manage various financial ratios related to working capital. Liquidity ratios such as the Current Ratio and Quick Ratio are often used to measure a company's ability to meet its short-term obligations (Yilmaz & Acar, 2022). Empirical research shows that companies that have healthy liquidity ratios tend to be more financially stable and better able to withstand market uncertainty, which ultimately contributes to more consistent profitability.

Apart from that, good working capital management also plays an important role in risk management and strategic decision making. For example, companies with good working capital management are more likely to take advantage of profitable investment opportunities because they have sufficient liquidity to support expansion or new innovation (Umar et al., 2023). Research shows that companies that proactively manage their working capital also tend to be more responsive to changing market conditions, allowing them to maintain or even increase their profitability over the long term.

It is important to note that poor working capital management can lead to additional costs and reduced operational efficiency. Excess inventory and uncollectible trade receivables can tie up funds that should be used for other productive investments (Koroma & Bein, 2024). Therefore, empirical research emphasizes the importance of regular monitoring and continuous adjustment of working capital strategies. Thus, effective working capital management is not only important for short-term performance, but also for the long-term success and sustainability of a business.

Analysis of the Most Impactful Working Capital Management Components

Working capital management consists of several important components that influence operational efficiency and the company's financial performance. The three main components of working capital management are inventory, accounts receivable and accounts payable. Each of these components has a significant impact on the company's liquidity and profitability (Suntraruk, 2023). For example, efficient inventory management allows companies to reduce carrying costs and prevent the buildup of unsold goods, which can ultimately increase profit margins.

Effective management of accounts receivable is also a critical component of working capital management. Accounts receivables that are too large and old can cause liquidity problems for the company, because funds that should be used for daily operations and other productive investments are tied up (Kisyeri & Kira, 2022). By implementing strict credit policies and effective collection practices, companies can accelerate the conversion of receivables to cash, reduce the risk of default, and improve their operational cash flow.

Business debt is the final component that plays an important role in working capital management. Good accounts payable management helps companies make maximum use of credit from suppliers without facing late payment penalties. By negotiating to obtain more favorable payment terms and taking full advantage of credit periods, companies can maintain free cash flow for other, more strategic purposes (Kasradze & Gikorashvili, 2024a). Therefore, a good balance between inventory management, accounts receivable and accounts payable is the key to achieving effective working capital management and ensuring long-term business continuity.

Apart from these three main components, working capital management also involves managing other components such as cash and marketable securities. The available cash must be sufficient to meet daily operational needs as well as to deal with unexpected emergencies (Shiba et al., 2023). Therefore, companies must have the right strategy in managing cash, such as monitoring cash inflows and outflows, making cash projections, and storing some cash in liquid investments that can be easily withdrawn if needed.

Financial ratio analysis, such as the current ratio and quick ratio, can be used to evaluate the efficiency of working capital management. The current ratio measures a company's ability to meet short-term obligations with its current assets, while the quick ratio provides a more conservative picture by excluding inventory from current assets. The ideal ratio shows that the company is able to manage working capital well, so that it has sufficient liquidity without needing to depend too much on external financing (Sohail & Quddus, 2022).

With the increasingly complex business environment and intense competition, companies must continuously update and perfect their working capital management strategies. The implementation of advanced information technology and management systems, such as Enterprise Resource Planning (ERP) and predictive analytics, can help companies optimize working capital management. For example, ERP can provide real-time data about inventory, receivables, and payables, allowing management to make faster and more informed decisions (Wardhani et al., 2023). Meanwhile, predictive analytics can help project future cash needs and liquidity risks, so that companies can plan the necessary steps to ensure smooth operations and business continuity.

Differences in Results in Different Industries or Business Sectors

Differences in working capital management in various industries or business sectors are often quite significant due to different operational characteristics and business cycles. For example, the details of working capital in the manufacturing industry are very different from those in the service or technology sectors. In the manufacturing industry, there is usually a great need to manage inventories of raw materials and finished products, which means companies must have sufficient working capital to withstand long production processes and longer payment times from customers (Prajawati, 2022). In contrast, the service sector typically does not have large inventory needs, but they must manage receivables more carefully because they depend on timely payments from clients to maintain positive cash flow.

Additionally, the retail industry often faces different challenges related to seasonal sales cycles and rapid inventory turnover. For example, seasonal retail sectors such as clothing or toys must manage their working capital carefully to ensure sufficient product availability during peak sales times such as year-end holidays, but must also avoid excess inventory that could result in heavy discounting and reduced profitability (Tahir & Baloch, 2023). While the technology sector, particularly software companies, may have a very different business model with a focus on selling software licenses or subscriptions that require careful working capital planning to support ongoing research and development.

In certain business sectors such as energy and utilities, companies often require significant working capital to fund large projects and expensive infrastructure. This sector may also face regulatory challenges that could affect cash flow and working capital requirements (Heliani, 2023). Therefore, these companies often use long-term contracts and complex forms of financing to ensure they have sufficient working capital to support their operations. Overall, it is important for each company to understand the specific characteristics of their industry or sector and develop a working capital management strategy tailored to their specific needs to maintain liquidity, operational efficiency and profitability.

The influence of government regulations and policies can also create significant differences across various business sectors. For example, in the pharmaceutical and healthcare industries, strict regulations regarding product research, development, and distribution require careful compliance and impact the timing of product launches to market. This may require companies to hold working capital longer before getting a return on investment (Rahman, 2022). On the other hand, sectors such as fast-growing technology may be less bound by strict product regulations, allowing for faster product iteration and potentially lower working capital cycles.

Furthermore, market risks and economic instability also influence differences in results across industries. Export-oriented sectors such as automotive or electronics manufacturing may be heavily influenced by exchange rate fluctuations, tariffs, or international trade policies, all of which have direct implications on working capital management strategies (Tago & Ponsian, 2024). In the banking and finance sector, changes in interest rates and macroeconomic conditions can affect the cost of capital and the ease of obtaining external funding, requiring careful management of working capital reserves to overcome market uncertainty.

Technological developments and innovation also play a role in creating differences in results in various business sectors. In the manufacturing industry, the application of automation and Internet of Things (IoT) technology can increase production efficiency and reduce inventory requirements, thereby influencing working capital management. In the retail sector, e-commerce and data analytics can change the way companies predict consumer demand and manage inventory (Arifani, 2023). Adoption of this technology gives companies the ability to optimize supply chains and minimize working capital tied up in inventory, driving higher efficiency and greater profit potential.

The Effect of Working Capital Management on Profitability

Working capital management is an important element in company operations which focuses on managing current assets and current liabilities to maintain the company's daily cash flow smoothly. Effective working capital management has a direct impact on a company's liquidity and stability. By maintaining a balance between accounts receivable, inventory and accounts payable, companies can avoid cash shortage situations that can hinder daily operations (Hung & Dinh, 2022). On the other hand, if it is not managed well, the company may face financial difficulties that can affect its survival.

Apart from that, good working capital management can increase company profitability. By optimizing the cash conversion cycle through efficient receivables collection, proper inventory management, and arranging payments to suppliers, companies can utilize available funds for other productive investments. This efficient use of working capital allows companies to minimize capital costs and increase return on investment (ROI) (Kasradze & Gikorashvili, 2024b). Additionally, companies with strategic working capital management can increase their competitiveness by offering better credit to customers without sacrificing their liquidity.

Effective working capital management is also closely related to financial planning and long-term strategic decision making. A conservative working capital policy can reduce liquidity risk, while a more aggressive policy can provide greater profit opportunities, but at a higher risk. Therefore, an appropriate balance is needed according to the company's conditions and business strategy (Rukh et al., 2023). Thus, good working capital management not only aims to maintain smooth operations, but also to increase profitability and long-term company sustainability.

CONCLUSION

Working capital management plays a crucial role in ensuring smooth operations and financial stability of a company. Effective management of current assets and current liabilities can prevent liquidity problems and enable companies to utilize funds optimally. With the right working capital management strategy, companies can increase investment value (ROI) and reduce operational costs, thereby improving overall profitability. In addition, the balance between conservative and aggressive working capital management must be adjusted to the conditions and business strategy of each company to achieve sustainability and competitiveness in the market. Good working capital management not only maintains smooth daily operations but is also key to creating solid long-term profitability.

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