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Research Article

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Effect of Working Capital Management on the Profitability of Manufacturing Firms: Evidence from Treveni Industries, Nepal

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Abstract

Working capital management (WCM) is a crucial determinant of a firm's financial stability and profitability, as it focuses on the efficient management of short-term assets and liabilities to ensure adequate liquidity for daily operations. This study examines the impact of WCM on the profitability of Nepal's manufacturing sector, using Treveni Industries Pvt. Ltd. as a case study, with specific focus on the Contech Concrete and allied industry. A descriptive research design is employed, and the analysis is supported by clearly presented tables. Secondary data were collected from audited financial statements of Treveni Industries Pvt. Ltd., along with relevant research articles, journals, and industry reports. The findings reveal that increases in the Inventory Turnover Ratio, Average Collection Period, Debt Ratio, and Current Ratio are associated with a decline in Return on Equity, whereas improvements in the Average Payment Period and Cash Conversion Cycle show a positive relationship with profitability indicators such as ROE and ROA. Overall, the study concludes that effective working capital management significantly influences profitability, accounting for approximately 25% of variations in industry profits.

Keywords: working capital management, manufacturing industry, profitability

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Introduction

Determining a company's profitability, risk, and overall worth depends on its working capital, which is a vital aspect for many organizations. No enterprise can function without it. Working capital is a crucial element of the company's higher-level corporate strategy (Shrestha, 2019). The manner in which a business manages and uses its working capital can greatly influence its ability to cover expenses, plan for future growth, and engage in additional operations, both in the short and long term.

Liquidity is essential and plays a key role in a company's success (Kandpal et al., 2013). Based on corporate finance theories, the main responsibilities of working capital management revolve around making choices related to investments and short-term financing for the business. Working capital management prioritizes

daily operations over future obligations (Masocha & Dzomonda, 2016). Previous studies have largely concentrated on analyzing long-term financial decisions, including aspects like investments, capital structure, or evaluations of business worth.

Profile of Treveni Industries Pvt Ltd Treveni Industries Pvt Ltd, founded in 2014 in Kathmandu Nepal. Which create a name for itself for prominent and well reputed manufacturing, Exporter and suppliers of RCC non pressure concrete pipe in Nepal. It believes in strong business ethics and as far as the client's concern, which has made it possible to attain trust and support from streamed customer.

Research Objectives

- To examine the working capital management practices of Treveni Industries Pvt. Ltd. in Nepal's manufacturing sector.
- To analyze the impact of key working capital components on the profitability of the firm.
- To assess the relationship between working capital management and profitability indicators (ROE and ROA).

Review of Literature

Shah (2023) investigated how working capital management influences the profitability of commercial banks. The study utilizes empirical data to examine the relationship between working capital management and various profitability metrics. Key financial indicators analyzed the credit-to-deposit ratio, cash reserve ratio, cash and bank balance to total deposits ratio, working capital turnover ratio, and liquidity ratios, treated as independent variables. Dependent variables measured include return on assets (ROA), return on equity (ROE), and net profit margin (NPM). The research focuses on a sample of seven out of twenty commercial banks in Nepal. A range of financial ratios and statistical tools were applied for the analysis, employing both descriptive and inferential methods to derive outcomes. Three regression models were tested, revealing statistical significance in the models for ROA, ROE, and NPM.

Garg & Singh (2023) examined the effects of working capital management on the profitability of Indian manufacturing companies. This research aims to analyze the connection between working capital management and the profitability of firms listed on the Bombay Stock Exchange in the Indian manufacturing sector. Utilizing the generalized two-step methods of moments (GMM) techniques suggested by Arellano and Bond, the sample includes financial data from BSE-listed companies covering the years 2012 to 2021. The empirical findings indicate that the coefficients for cash conversion cycle (CCC) and inventory conversion period (ICP) are both positive and significant, while the coefficients for receivables collection period (RCP) and accounts payable (APP) are negative concerning Tobin's Q. Regarding return on capital employed (ROCE), the coefficients for CCC, ICP, RCP, and APP are also positive and significant. Unlike previous research that indicated a linear relationship between working capital management and firm profitability, this study identifies an inverse relationship

Arulanandam, Glinkowska-Krauze, & Tan (2023) analyzed how working capital management affects the profitability of manufacturing firms from an emerging market perspective. Their findings highlight a significant positive association between inventory turnover in days, accounts receivable, and firm size with profitability. On the other hand, accounts payable and cash conversion cycle presented positive but insignificant relationships.

Poudel & Maharjan (2020) explored the link between the characteristics of working capital and firm profitability in Nepal. They investigated whether firm performance, as measured by return on assets, relates to metrics like cash conversion cycle, days sales outstanding, days inventory outstanding, and current ratio. The research employed a descriptive and causal-comparative design. Results indicated a positive significant relationship between current ratio and profitability, while days sales

outstanding had a negative significant relationship with the firm's financial performance.

Duwadi (2024) examined the relationship between working capital management and profitability within the hotel industry in his Master's degree unpublished thesis, focusing on essential financial metrics such as inventory conversion period, receivables collection period, payables deferral period, and cash conversion cycle. The regression analysis suggests that efficient working capital management notably enhances financial performance, particularly in terms of return on assets (ROA) and return on equity (ROE). Findings indicate that a shorter inventory conversion period and more effective receivables collection contribute positively to profitability. These results are consistent with previous studies emphasizing the importance of timely operations and effective liquidity management. Additionally, an optimized cash conversion cycle promotes financial performance by ensuring adequate cash flow while reducing operational delays. Conversely, the payables deferral period showed mixed outcomes; while deferring payments might temporarily enhance liquidity, excessive delays can harm supplier relationships, ultimately impacting profitability

Research Gap

Numerous studies have been carried out on working capital management (WCM) practices across various industries on both national and international levels. However, focused research on WCM in Nepal's unlisted small industries is limited. Consequently, this paper refers to previous journals, theses, and reports to serve as a vital resource for comprehending small manufacturing industries worldwide.

Were,

$X_4+\beta_5X_5+\beta_6X_6+ei$

Y_1 = Return on Assets (Dependent Variable)

Y_2 = Return on Equity (Dependent Variable)

X_1 = ACP (Independent variable)

X_2 = APP (Independent variable)

X_3 = ITR (Independent variable)

X_4 = CCC (Independent variable)

X_S= DR (Independent variable)

X_6 = CR (Independent variable a=Constant

β_1, β_2, β_3, β_4, β_5, and β_6 are regression coefficients of Factor 1, Factor 2, Factor 3, Factor 4, Factor 5 and Factor 6 respectively.

ei = Error Term

Methodology

This study employs a descriptive research design. The findings are analyzed and presented clearly using suitable tables. To draw conclusions, the complete financial statements of Westage Industries Pvt Ltd are incorporated into the analysis. Secondary data was collected from the audited reports of Treveni Industries Pvt Ltd, along with research papers, articles, and case studies related to manufacturing industries or similar WCM practices published in journals, magazines, or trade publications. Among the many listed and unlisted manufacturing sectors in Nepal, only one non-listed manufacturing sector was chosen as a sample for this in-depth study. A multiple linear regression model was used to analyze the dat

Model Specification

The regression equation for impact of independent variables is expressed in the following equation:

$$Y_1 = a+ \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4+\beta_5 XS +\beta_6X_6+ei$$

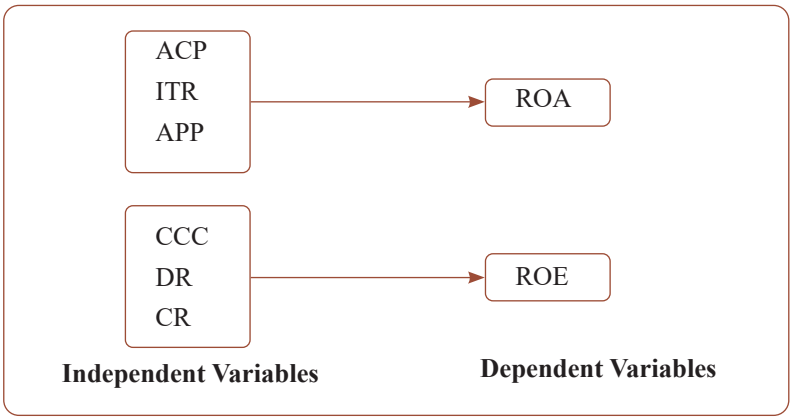
$$Y_2 = a+ \beta_1 X_1 + \beta_2X_2 + \beta_3 X_3 + \beta_4$$

Research Framework and Definition of Variables

The conceptual framework for this study is based on prior research and studies. Duwadi (2024) formulated a conceptual framework in his work "Working Capital Management Practices in the Hotel Industry of Nepal," identifying independent variables such as ICP, APP, ITR, CCC, DR, and CR, while ROE and ROA were classified as dependent variables. Utilizing this framework, the following conceptual framework has been established for the study:

Figure 1

Conceptual Framework



Note. Duwadi, 2024.

Average Collection Period (ACP)

The average collection period (ACP) indicates the duration needed to receive payments from debtors. It is calculated by dividing accounts receivable by sales and multiplying the outcome by 365 (Raheman & Nasr, 2007). A company's goal is to minimize the interval between sales and customer payments. Numerous studies have demonstrated a negative correlation between the receivables collection period and profitability, examining various sectors such as fast-moving consumer goods in Malaysia, Pakistan, the Nairobi Stock Exchange, and the New York Stock Exchange (Gill et al., 2010; Mishra & Aithal,2021). The hypothesis for this research is stated as follows:

HO: ACP is negatively associated with performance (ROE and ROA) of the industry.

Average Payment Period (APP)

The time it takes for businesses to pay their creditors is known as the average payment period (APP). Usually, it is acquired by obtaining free credit from creditors. Although timely payments can result in discounts, research indicates a negative association with profitability. Nonetheless, there is a favorable correlation with profitability indicators such as Return on Equity and Return on Assets (Gill et al., 2010), The research's hypothesis is as follows:

HO APP is negatively associated with performance (ROE and ROA) of the industry.

Inventory Turnover (ITR)

The inventory turnover ratio measures a company's inventory turnover by dividing inventory by the cost of goods sold and multiplying by 365 days. A negative correlation has been observed between inventory conversion period and business profitability, with extended periods leading to reduced profits. Conversely, a positive correlation has been found in Kenyan firms and the Malaysian manufacturing sector (Duwadi, 2024). For the research, hypothesis is drawn as:

HO ITR is negatively associated with performance (ROE and ROA) of the industry.

Cash Conversion Cycle (CCC)

The cash conversion cycle is the time gap between cash spent on raw materials and cash inflow from sales. Research shows a negative association between the cash conversion cycle and a firm's profitability, while a positive correlation has been found (Al-Debi'e, 2011; Azam & Haider, 2011; Affeef, 2011). This cycle represents the time gap between cash spent on raw materials and cash inflow from sales. For the research, hypothesis is drawn as:

HO CCC is negatively associated with performance (ROE and ROA) of the industry.

Debt ratio (DR)

The debt ratio, which represents the ratio of total debt/liabilities to total assets, is often linked to a firm's profitability, even with an increase in debt. However, most studies show a significant negative relationship between the debt ratio and profitability, with unfavorable debt affecting profitability and increasing default risk (Duwadi, 2024). This contradicts the idea that a good economic condition can lead to increased profit for firms. For the research, hypothesis is drawn as:

HO DR is negatively associated with performance (ROE and ROA) of the industry.

Current Ration (CR)

Current ratio measures a firm's liquidity by dividing current assets by current liabilities (Raheman & Nasr, 2007; Gautam & Mishra,2024). It is expected to have a higher current ratio in favorable situations where current liabilities can be easily paid off. There is a positive and statistically significant relationship between the current ratio and profitability. In under-developed capital markets, higher current assets may not destroy shareholder value, but a negative relationship exists. For the research, hypothesis is drawn as:

HO CR is positively associated with performance (ROE and ROA) of the industry.

Dependent Variables

This study uses Return on Assets (ROA) and Return on Equity (ROE) to evaluate the profitability of manufacturing firms. ROE is a profitability ratio, comparing net income to total equity. A higher ROE is advantageous for a company, while higher ROA values indicate management efficiency in converting assets into profits (Adhikari, 2020). Previous research has identified ROA as a dependent variable and found significant relationships with other variables. More profitable businesses typically report higher ROA values.

Results and Discussion

Association between key variables Spearman's Correlation analysis is used to determine the Association between key variables. For this analysis SPSS version 30 was used in carrying out the analysis and extracted the following results.

Table 1

Descriptive Statistics and Correlation with Respect to ROA

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1) ROA	1.000						
(2) ITR	-0.648*	1.000					
	(0.045)						
(3) ACP	0.849**	0.831**	1.000				
(4) APP	-0.101	-0.490	-0.279	1.000			
	(0.787)	(0.151)	(0.435)				
(5) CCC	-0.651	0.912	0.924***	-0.615*	1.000		
	(0.037)	(0.000)	(0.000)	(0.058)			
(6) CR	0.346	-0.799***	-0.538	0.485	-0.675**	1.000	
	(0.324)	(0.006)	(0.109)	(0.156)	(0.032)		
(7) DR	-0.321	-0.368	0.137	0.267	-0.066	0.501	1.000
	(0.368)	(0.295)	(0.705)	(0.457)	(0.856)	(0.140)	

Note. Pval in parentheses *** p<0.01, ** p<0.05, * p<0.l, Research data, 2024

Table 1 displays the pair wise correlations between ROA and essential financial metrics. ROA shows a negative correlation with ITR (-0.648), which is statistically significant at the 5% level, implying that an extended inventory conversion period diminishes profitability. In a similar vein, ACP has a substantial negative correlation with ROA (-0.849), with high significance at the 1% level, indicating that prolonged receivables collection periods harm profitability. The correlation between ROA and APP (-0.101) is insignificant, suggesting there is no substantial relationship. Additionally, ROA is negatively correlated with CCC (-0.651), which is significant at the 5% level, highlighting the adverse effects of longer cash conversion cycles on profitability. The correlation with the Current Ratio (0.346) is positive but not statistically significant, indicating that liquidity has a limited effect on ROA. Lastly, the correlation with DR (-0.321) is negative and also insignificant, suggesting that leverage does not have a major influence on profitability within this dataset.

Table 2

Correlation Matrix of Working Capital Variables and ROE

Variables	(1) ROE	(2) ITR	(3) ACP	(4) APP	(5) CCC	(6) CR	(7) DR
(1) ROE	1.000						
(2) ITR	-0.711**	1.000					
	(0.022)						
(3) ACP	-0.862***	0.831***	1.000				
	(0.001)	(0.003)					
(4) APP	-0.063	-0.490	-0.279	1.000			
	(0.865)	(0.151)	(0.435)				
(5) CCC	-0.691**	0.912***	0.924***	-0.615*	1.000		
	(0.026)	(0.000)	(0.000)	(0.058)			
(6) CR	0.421	-0.799***	-0.538	0.485	-0.675*	1.000	
	(0.232)	(0.006)	(0.109)	(0.156)	(0.032)		
(7) DR	-0.197	-0.368	0.137	0.267	-0.066	0.501	1.000
	(0.590)	(0.295)	(0.705)	(0.457)	(0.856)	(0.140)	

Notes. *** p<0.01, ** p<0.05, * p<0.I, ***Correlation is significant at the 0.05 level (2- tailed)

Table 2 displays the pairwise correlations between ROE and various important financial metrics. There is a significant negative correlation between ROE and ITR (-0.711) at the 5% level, which suggests that longer inventory conversion times are linked to lower profitability. Similarly, ACP shows a strong negative correlation with ROE (-0.862), significant at the 1% level, indicating that slower receivables collection negatively impacts profitability. The correlation with APP (-0.063) is not significant, suggesting there is no important relationship. ROE has a negative correlation with CCC (-0.691), significant at the 5% level, which implies that longer cash conversion cycles lead to reduced profitability. Meanwhile, the correlation with the Current Ratio (0.421) is positive but not statistically significant, indicating liquidity does not have a notable impact on ROE. Finally, DR

presents a negative correlation with ROE (-0.197), but it is statistically insignificant, showing no clear link between leverage and profitability in this analysis.

Table 3

Return on Assets withACP, CCC, DR, ITR,APP, CR

ROA	Coef.	St.Err.	t-value	p-value	[95% Conf	Interval]	Sig
ITR	-23.01	4.656	-5.16	.014	-38.828	-9.191	**
ACP	-28.947	7.032	-4.26	.024	-52.325	-7.57	**
APP	4.989	2.388	2.33	.103	-2.045	13.155	
CCC	18.374	4.381	4.40	.022	5.335	33.221	**
CR	-1.78	2.864	-0.64	.568	-10.944	7.282	
DR	-19.42	10.712	-1.91	.153	-54.51	13.673	
Constant	187.05	37.263	5.13	.014	72.498	309.671	**
Mean dependent var		9.498	SD dependent var				8.204
R-squared		0.775	Number of obs				10
Adjusted R- squared		0.760	Prob> F				0.007
Akaike crit. (AIC)		40.667	Bayesian crit. (BIC)				42.785

Note. *** p <.01, ** p <.05, * p <.1

The regression analysis reveals important insights into the factors influencing ROA, consistent with previous studies on financial performance. The Inventory Conversion Period (ITR) shows a negative and significant relationship with ROA (coefficient= -23.01, p = 0.014), indicating that longer inventory periods diminish profitability. This aligns with research by Deloof(2003), which found that effective inventory management positively impacts a firm's profitability. Similarly, the Receivables Collection Period (ACP) also has a significant negative effect on ROA (coefficient= - 28.947,p=0.024).

On a different note, the Cash Conversion Cycle (CCC) presents a positive and significant correlation with ROA (coefficient= 18.374, p = 0.022). The Payables Deferral Period (APP) indicates a positive yet statistically insignificant link with ROA (coefficient = 4.989, p = 0.103), suggesting that delaying payments may not have a direct impact on profitability.

Model Summary of Regression Analysis

The analysis of below model Summary gives various results of correlation coefficients after considering a set of data.

Furthermore, other factors such as the Current Ratio (CR) and Debt-to-Equity Ratio (DER) show insignificant effects on ROA, with coefficients of -1.78 (p = 0.568) and -19.42 (p = 0.153), respectively. These results imply that liquidity and leverage do not significantly influence profitability in this scenario, contrasting with some studies that argue for their relevance. The overall model accounts for 77.5% of the variation in ROA (R-squared = 0.775) and shows statistical significance with p values at 0.007, indicating strong explanatory capability and robustness. In conclusion, this analysis supports earlier research highlighting the critical role of effective working capital management in boosting profitability. Specifically, reducing inventory durations and receivables collection periods, alongside optimizing the cash conversion cycle, significantly enhances ROA. Nonetheless, the results also indicate that the significance of factors such as liquidity and leverage may depend on the particular context or industry studied.

Regression Line

$$Yl = a+\beta_1 X_1 +\beta_2X_2+\beta_3X_3+\beta_4X_4+\beta_5X_5 +\beta_6X_6+ei$$

Return on Assets = 187.05-23.01ICP-28.947 ACP+4.989APP+ 18.374 CCC-19.42 DR-1.78 CR+ei

In regression analysis, beta coefficients illustrate the importance of independent variables in accounting for the variance in the dependent variable. Table shows a positive relationship between ROA with the independent variables APP, and CCC and a negative relationship between ROA with the remaining independent variables ITR, ACP, DR and CR. This means that enhancements APP, and CCC result in increased ROA, while enhancements in ITR, ACP, DR and CR result in a decline in ROA, assuming that all other variables are held constant.

Table 4

Return on Equity with ITP,ACP,APP, CCC, DR, & CR

ROE	Coef.	St. Err.	t-Value	p-Value	95% conf.	Interval	
ITR	-33.76	7.499	-4.60	.019	-58.321	-10.594	**
ACP	-48.78	11.324	-4.70	.018	-89.313	-17.238	**
APP	9.87	3.846	2.72	.073	-1.785	22.694	*
CCC	31.93	7.056	4.62	.019	10.122	55.03	**
CR	-4.53	4.612	-0.87	.447	-18.703	10.649	
DR	-6.91	17.252	-0.43	.694	-62.376	47.428	
Constant	202.22	60.01	3.57	.038	23.257	405.212	**
Mean dependent var		14.181	SD dependent var				12.251
R-squared		0.758	Number of obs				10
Adusted R-squared		0.736	Prob> F				0.009
Akaike crit. (AIC)		50.197	Bayesian crit. (BIC)				52.315

The regression analysis underscores critical factors influencing Return on Equity (ROE) and identifies statistically significant connections that align with earlier studies on financial performance. The Inventory Conversion Period (ITR) shows a negative correlation with ROE (coefficient= -33.76, p = 0.019), suggesting that longer inventory holding durations diminish equity returns. This observation is consistent with Deloof (2003), who highlighted the negative impact of poor inventory management on company performance. Likewise, the Receivables Collection Period (ACP) reveals a noteworthy negative association with ROE (coefficient = - 48.78, p = 0.018), which stated that delayed collection of receivables adversely affects equity returns.

In contrast, the Cash Conversion Cycle (CCC) presents a positive and significant link to ROE (coefficient= 31.93, p = 0.019), indicating that refining the cash conversion process can improve equity profitability. The Payables Deferral Period (APP) indicates a positive, yet marginally significant relationship with ROE (coefficient= 9.87, p = 0.073), implying that extending payment periods may offer liquidity benefits for companies.

On the other hand, the Current Ratio (CR) and Debt-to-Equity Ratio (DR) show insignificant impacts on ROE, with coefficients of(-4.53, p = 0.447) and (-6.91, p = 0.694), respectively. This suggests that liquidity and leverage might not significantly influence equity returns within this sample. The model exhibits strong explanatory power, evidenced by an R-squared value of

O.758 and a p-value of 0.009, indicating that the independent variables together account for a considerable portion of the variability in ROE.

In summary, the analysis highlights the significance of effective working capital management for maximizing equity profitability. Prolonged inventory and receivables periods have a negative effect on ROE, while optimizing the cash conversion cycle positively influences returns. These results revealed the complex role of liquidity and leverage in financial performance.

Regression line

$Y2= a+\beta_1X_1+\beta_2X_2+\beta_3X_3+\beta_4X_4+\beta_5X_5+\beta_6X_6+ei$

Return on Equity = 202.22 -33.76 ITR-48.78ACP+ 9.87 APP+31.93 CCC-6.91 DR-4.53 CR+ei

In regression analysis, beta coefficients represent the significance of independent variables in explaining the variance in the dependent variable. Table 4.28 indicates a positive correlation between ROE and the independent variables APP and CCC, while it shows a negative correlation between ROE and the other independent variables ITR, ACP, DR, and CR. This suggests that improvements in APP and CCC lead to an increase in ROE, whereas enhancements in ICP, RCP, DR, and CR are associated with a decrease in ROE, assuming all other variables remain constant.

Conclusion

The aim of this research paper was to examine how working capital management affects the profitability of Nepal's manufacturing sector. This study will help future researchers, policymakers, stakeholders, investors, and management teams better understand the significance of working capital management in boosting profitability within the manufacturing industry.

By analyzing a decade's worth of data from Treveni Industry Private Limited, it was determined that factors such as average collection period, average payment period, cash conversion cycle, inventory turnover ratio, debt ratio, and current ratio had a significant connection to the industry's profitability. Improvements in cash conversion cycle, debt ratio, and current ratio were associated with a reduction in return on equity (ROE). In contrast, variations in average collection period, average payment period, and inventory turnover ratio showed a positive correlation with ROE. At the same time, average collection period, average payment period, inventory turnover ratio, and cash conversion cycle were positively linked to return on assets (ROA), while they exhibited a negative relationship with debt and current ratios. Essentially, maintaining an optimal level of working capital is vital for achieving higher profits, as the findings suggest that around 25% of the changes in a manufacturing company's profits stem from effective working capital management.

Given that this research was based on eleven years of data from Treveni Industries Pvt Ltd, it is suggested that future studies include additional information from a range of manufacturing sectors by incorporating more factors, such as economic growth, operating profit, and company size. Despite certain limitations, this study provides valuable insights into how working capital management affects the profitability of manufacturing industry in Nepal.

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