

Does Working Capital Management Impact How Well a Company Performs? Panel Data Analysis on the Textile Industries of Bangladesh

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Abstract

Managing working capital is vital to the expansion and development of manufacturing companies. The performance of Bangladeshi textile industries and the implications of working capital management are the main focus of this study. Working capital is represented by the inventory conversion period, receivable collection cycle, payable deferral cycle, and cash conversion cycle, whereas firm performance is determined by ROA. From 2013 to 2022 ten years panel data were collected from the annual reports of ten listed textile companies of Bangladesh. Panel Least Square (PLS), fixed effect, random effect, and the Hausman test were all executed using the STATA program to determine the influence of independent factors on the dependent factor. The ROA of Bangladesh's textile industries was found to be significantly affected by the Inventory Conversion time, Receivables Collection time, and Cash Conversion Circle, but not by the Payable Deferral time.

Keywords: cash conversion, working capital, receivable collection, deferred payable, inventory conversion, and firm performance

1. Introduction

Any organization's finance manager is required to perform three tasks. Maintaining long-term resources, long-term investment, and short-term assets and obligations are some of these responsibilities. The supervision of short-term resources and obligations is connected to the supervision of working capital (Khan, 2002). The corporation should not hang onto any non-productive assets and should invest with the minimum cheap sources of capital accessible in order to maximize earnings. Generally, the company will make money if it finances with temporary debt and invests in working capital (Scherr, 2007). Working capital administration is crucial to preserving the company's financial stability throughout routine business activities. When conducting regular operations, a business must strike a balance between liquidity and profitability. A successful business needs liquidity to make sure it can cover its short-term liabilities and assure its current cash flow (Padachi, 2006). Using the cash effectively for daily operations is part of utilization of working capital, which also include maintaining the ideal balance of the three primary working capital elements—receivables, inventories, and payables. Optimizing the working capital balance entails lowering the need for working capital and maximizing income (Ganesan, 2007). The profitability of the business and its working capital effectiveness are closely related (Shin, 1998). The capacity of a business to generate profit is denoted as profitability. Revenue is compared to corresponding costs to calculate profit (Salaudhin, 2001). An enterprise's profit in absolute terms deals insight into the outcome of its actions. Profitability is a commonly used term to measure financial performance. Profitability can be categorized into two categories: private/commercial profitability and public profitability. Although public profitability, which is constructed on economists' concept of cost and profits, i.e., the genuine opportunity cost and the welfares for civilization as a whole, seems to be a more suitable degree of outcomes of government firms, it has been considered in this research. For this cause commercial profitability, which is widely accepted and simple to understand, is regularly used to evaluate the outcomes of publicly traded companies in Bangladesh and even in other nations like India, the UK, and France. The two basic profitability ratios that are computed are profitability as a percentage of revenue and profitability relative to utilization of funds. Gross profit margins (GPM), net operating margins (NOM), returns on assets (ROA), returns on

shareholders' equity (ROE), and returns on investment (ROI) are the focal indicators of firm's performance. Profitability is a relative indicator of a firm's operational competence, whereas profit is an absolute indicator. Publicly limited companies are the lifeblood of a country's economy. The development, rise, and fall of these institutions generally mirror the financial state of the nation. An economy's stage of development can be roughly predicted by looking at the development and weakening of publicly traded companies. Because of the nation's booming trade, business, and industry, there are becoming more publicly traded companies in Bangladesh. The economy of the country is significantly impacted by these companies. An essential component of industrialization in the nation is textile production. The textile sector today drives Bangladesh's economy. Its expansion reveals the nation's financial stability. It is encouraging to see how Bangladesh's economy has benefited from textile companies. The fact that there is more investment in this industry shows how promising it is. The CSE and DSE both include 55 and 58 textile companies, respectively. The Industrial Life Cycle analysis reveals that all of the listed enterprises have only recently entered the middle phase. No company has yet been able to mature. In a nutshell, the nation's textile industry is only getting better. This industry exports to foreign markets in addition to meeting local market need. Current data indicate that this sector's performance is substandard when compared to that of other manufacturing sectors. To ascertain whether poor working capital management is to blame for the textile industry's poor performance, an effort has been made to look into the reasons behind it. Both a correlation matrix and regression analysis have been used to inspect the association between profitability and working capital administration. Using the methods of statistics like mean, standard deviation, and co-efficient of variance, the performance was evaluated.

2. Literature Review

Working capital management has been the important issue for details research in both the public and commercial sectors, together with international business in Bangladesh. In his paper "Working Capital Management: A Study on British American Tobacco Bangladesh Company Limited," Due to the progressive outcome and strategic method to manage the key components of working capital, Sayaduzzaman (2006) states that British American Tobacco Bangladesh Company Ltd.'s effective handling of working capital is extremely gratifying. He showed that maintaining overall operational efficiency is facilitated by working capital administrations. Eljelly (2004) scrutinised the association within profitability and liquidity in the paper "Liquidity-Profitability Trade-off: An Empirical Investigation in an Emerging Market" utilizing correlation and regression techniques and discovered that the cash conversion circle was more significant as a indicator of liquidity than the ratio of current assets to current liabilities that affects the firms performance. Rahman (2007) looked into the effects of various working capital administration variables on the net operating profitability of Pakistani companies, including the mean collection time, days required to convert inventory into finished goods, average days delayed to pay to the suppliers, cash conversion circle, and ratio of current assets to current liabilities. Getting result from the correlation and regression, he establish that there was a significant adverse association between the indicators of working capital management and firms' performance. He also discovered that the firm's profitability decreases as the cash conversion circle lengthens. By reducing the cash conversion circle, decision makers can increase value for shareholders. A study into the working capital patterns of Bangladeshi organizations was done in 1994 by Islam and Rahman. They showed that having the right amount of working capital helps a business maintain its credit upright, allow debt payments on time, and keep itself in a reasonably liquid state, all of which assist the business be more appealing to banks for loans. In order to ascertain whether working capital administration has an influence on profitability, Deloof (2003) studied Belgian companies. He found that working capital was a important expense for the majority of businesses. How those businesses handle their working capital will probably have a big impact on how profitable they are. He revealed a substantial inverse connotation between corporate profitability and the duration to recover inventories, current assets and current liabilities of the firms' from Belgian with the help of correlation and regression analyses. He asserted that managers may rise organizational performance by limiting the amount of days' worth of accounts receivable and inventories. The adverse link between current liabilities and performance of firms supports the hypothesis that less lucrative businesses do late to pay their invoices for longer periods of time. According to the research of Padachi (2006), a business must keep a stability between liquidity and firm's performance while running its regular business. To enhance a firm's value, the management of a corporate entity must strike the right equilibrium between liquidity and productivity. In 2006, Lazaridis and Tryfonidis (2006) studied on management of working capital and corporate performance of listed organizations on the Athens Stock Exchange. According to the study's findings, significant association was found between firm's performance and the cash conversion circle. Also, managements could upturn productivity for their organizations by dealing the cash conversion cycle appropriately and upholding the optimal level of each component (accounts receivable, accounts payable, and rawmaterials). Effective working capital

administration, according to Ganesan, V. (2007), rises a company's available cash flow, which in turn enhance its growth and shareholder earnings. An article titled "Working Capital Management Practices in Pharmaceutical Firms Listed in DSE" was written by Chowdhury and Amin in 2007. The issues with working capital management are perhaps the most significant ones among all the issues with financial management. While working capital constantly aids in giving a business concern life and power while maximizing profit, this is the case. In order to to increase shareholder value, Shin and Soenen (1998) claimed that effective working capital administration is essential. Profitability and liquidity were both significantly impacted by how working capital was managed. They supported the connection between the extent of the net business cycle, firm performance, and return on risk-adjusted share utilizing correlation and regression analysis. They establish an important inverse link between the profitability of the organization and the span of its net trading cycle. They also showed that higher risk-adjusted stock returns were linked to shorter net trade cycles.

3. Objective of the Study

The study's main goal is to investigate how working capital management affects business success. Following are some specific objectives for the study that will help to achieve its main objective:

To inspect the impact of the inventory conversion period on the performance of the firm

To ascertain the effect of the firm's performance on the receivables collection period.

To investigate how payable deferral duration affects manufacturing enterprises' profitability.

To investigate how the cash conversion cycle affects the firm's performance.

4. Theoretical Framework for Working Capital Management and Firm Performance

4.1 Return on Asset (ROA)

Return on assets, a performance indicator, express the possible profit a firm could grasp by utilizing its assets. Alternatively, ROA indicates the effectiveness with which an organization's management makes income from the resources or financial properties that appear on the firm's balance sheet. The more effectively a company manages its assets, the more ROA it will be able to produce. Mean value of total assets are used in the estimation of ROA since a firm's total assets can change with time as a result of the purchase or sale of vehicles, real estate, or apparatus and adjustments to raw materials or variations in seasonal sales. As a result, it is more accurate to determine the average total assets over the required period rather than the total assets for a particular date. Total assets of a company are available in the balance sheet of the company.

4.2 Inventory Conversion Period (ICP)

The inventory conversion time, or the period between buying new stock and the actual product sale, establishes how long it takes to change inventory into sales. To identify the accurate number of days that inventory is converted into sales, divide inventory by the mean sales or cost of goods sold and then multiply by 365 or divide 365 by the inventory turnover. As of the date of the balance sheet, inventory is taken. To determine the precise conversion period, internal calculations would use the cost of sales and average daily sales as a benchmark. While the net sales for the year would be considered for showing in the financial statement so that every reader could comprehend the analysis and compare it to the industry conversion ratio. The organization's gross profit margin is calculated as the sales price less the cost of sales. As a result, some businesses don't use the average revenues while calculating this time to find the exact conversion period. In contrast, it is also true that the analyst records this time frame by taking sales into account. Because it makes easy to understand the financial statement to its users. Sales serve as the foundation for determining the conversion cycle because the organization must ultimately convert inventories into sales.

4.3 Receivable Collection Period (RCP)

The duration of time requires for a business to get payments from its buyers in the form of accounts receivable denoted to as the "receivable collection period" (RCP). Companies use the receivable collection period for becoming sure that they have sufficient cash to satisfy their financial requirements. The average collection duration is a crucial indicator for the firms that depend deeply on receivables for their cash flows since it discloses how successfully a company utilizes its accounts receivable.

4.4 Payable Deferral Period (PDP)

The Payment Deferral Period is the period of time that an organization waits before paying its creditors. It is a financial ratio that consider accounts payable and the number of days they go unpaid to assess how long it generally

takes a company to pay bills and invoices. For instance, if the payable deferral time is ten days, it means that it will take the business ten days to pay the suppliers. Days Payable Outstanding is another phrase that indicates this idea (DPO). This ratio is often calculated quarterly or yearly by an analyst or by the business itself. It essentially shows how effectively a business controls its cash flows. For example, if a business pays suppliers slowly, it may be experiencing a liquidity crisis or keeping more cash to itself. If a business keeps its money, it can put it to other useful uses. Perhaps it might invest the funds for a relatively short-term to generate interest.

4.5 Cash Conversion Cycle (CCC)

The cash conversion cycle is the extent of period (in days) required for a firm to convert its raw materials into finished products and then make cash pan of time (in days) it requires for a company to convert its investments in raw materials and other material into cash flows from sales (CCC). The CCC, frequently denoted to as the net working cycle or merely the cash cycle, pursues to identify how extensive each net input cash remains in the manufacturing and sales rotation before it is transformed into liquid assets. This indicator takes into what length of time any firm required to convert its' inventory, to accumulate funds form its debtors, and make payments to its suppliers. The CCC is one of many quantitative dealings that are employed to evaluate how well a firm's management and operations are carried out. A trend of decreasing or steady CCC rate over some duration is a strong indicator, whereas increasing CCC figures should trigger deeper examination and analysis on the basis of other symptoms. Always it has to consider that CCC only relates to particular organizations that have the dependency on inventory management and related procedures.

5. Techniques Used in the Research

5.1 Data Sources

This study is empirical in nature. Here, the researcher used a sample size of significant Bangladeshi textile enterprises and applied judgemental sampling. Over the years 2013 through 2022, information on 10 textile companies was gathered from their annual reports. The gathering of secondary data is the foundation of this study.

5.2 Tools for Data Analysis

The data analysis was done using STATA software. The data were analysed using Panel Least Square (PLS), fixed effect, random effect, and the hausman test. The nature of the data was determined applying descriptive statistics, and the correlation between the variables was displayed by means of a Pearson zero order correlation matrix.

5.3 Variables and Details of the Model

Table 1. Variable Measurement

	Variables	Full Explanation	Definition
Dependent Variable	ROA	Return On Assets	Intended as the Net Profit to Total Assets Ratio.
	ICP	Inventory Conversion Period	Determined by number of days in a year multiplied by the inventory turnover.
	RCP	Receivable Collection Period	Intended by dividing the number of days in a year by the volume of accounts receivable.
Independent Variables	PDP	Payable deferral Period	Based on the amount of days in a year divided by the payable turnover.
	CCC	Cash Conversion Cycle	Intended by totaling the inventory conversion period and the receivable collection time, then subtracting the payable deferral period.

Source: The researcher's compilation

5.4 Model Specification

$$ROA_{it} = ICP_{it} + RCP_{it} + PDP_{it} + CCC_{it} + e_{it}$$

H_{01} : The performance of the firm is unaffected by the inventory conversion period.

H_{02} : The profitability of Bangladesh's textile industries is unaffected by the span of period it takes to collect receivables.

H_{03} : A company's performance is unaffected by the payment delay period.

H_{04} : The performance of the Bangladeshi textile sector is unaffected by the cash conversion cycle.

6. Analysis and Findings

Table 2

	ROA	ICP	RCP	PDP	CCC
Mean	0.0408	98.33	89.91	59.54	128.71
Minimum	0.0012	11.12	27.33	19.15	11.21
Maximum	0.1214	250.21	195.36	99.41	336.1
Stand.Dev.	0.0271	42.87	41.30	21.76	73.98

Annual Reports as a Source (2013-2022)

6.1 Data Were Taken From Information Analysis in STATA

Table 2 provides descriptive statistics to provide an in-depth consideration of the characteristics of the data so that judgments about whether the results are helpful for decision-making may be made. The range between the highest and lowest ROA values is more constrained, and the average ROA is 4.08 percent, which is acceptable and appropriate. The typical turnaround time for this industry to convert inventory into cash is 98.33 days. Inventory conversion times range from 250.21 days to 11.12 days, respectively. The mean value of the receivable collection period (RCP) for the Bangladeshi textile business is 89.91 days, meaning that on average, it takes 89.91 days to recover its receivables from the creditor. This industry can defer paying its suppliers for 59.54 days. 19.15 days are the minimum payable deferral period.

Table 3. Pearson Correlation Matrix of Variables

	ROA	RCP	ICP	PDP	CCC
ROA	1				
RCP	-.084	1			
ICP	-.065	.604**	1		
PDP	-.333**	.196	.178	1	
CCC	-.013	.851**	.864**	-.082	1

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

To assess the multicollinearity of the gathered data, Table 3 shows the Pearson correlation matrix for each variable. Receivable collection times are inversely correlated with return on assets and return on equity, which suggests that if a company takes too long to collect its accounts receivable from its customers, a liquidity crisis could result, which would lower the profitability of the company. Since its expansion lengthens the cash conversion cycle, collection of receivables was found to have a positive relationship with it. Because it will take longer to change inventory into finished items, it will be harder to sell the goods and generate revenue, which is why inventory conversion period is

found to be adversely connected with return on assets. Payable deferral periods are positively correlated with the firms return on assets, indicating that if the firm is late in making payments to its suppliers, it won't be necessary to obtain a short-term bank loan or another type of short-term financing. However, this may harm the firm's relationships with its suppliers. Because a rise in this cycle is associated with a firm's liquidity delay, it has a negative relationship with ROA. The relationship between the duration of inventory conversion and the cycles of cash conversion, payable deferment and receivable collection is favorable. The cash conversion cycle is adversely correlated with the payable deferral time.

Table 4. Operational Results of Panel Least Squares (PLS)

Variable	Panel Least Squares			
	Co-efficient	Std. Error	t-statistic	p-value
Constant	-0.104948	0.343374	-0.0933442	0.66521
RCP	-0.1290237	0.000185	-2.701345	0.03404
ICP	-0.045030	0.176470	1.852503	0.07656
PDP	0.018581	0.014644	2.170029	0.04990
CCC	-0.104946	0.012217	0.264504	0.79170
R-square.			0.257125	
Adjusted R-squared.			0.191385	
F-statistic			8.313635	
Prob. (F-statistic)			0.000000	

Source: Annual Reports (2013-2022)

Note: a) Data have been compiled by Researcher

b) Data extracted from analyzing information on STATA

Table 4 displays the empirical findings of the panel least squares method used to recognising the components of working capital. As the receivable collection period's p-value is less than 5% and it has a negative correlation, it has an important influence on the performance of the textile industry. The performance of Bangladesh's textile industries was not found to be primarily affected by inventory conversion times or cash conversion times, however payable deferral times were discovered to be a key determinant in this sector's profitability. The adjusted R-squared value is 19.13%, which shows that the aforementioned independent variables account for 19.13% of the dependent variable. The Hausman test (1978) gives explicit instructions on how to employ the right approaches, indicating whether the fixed effect or random effect will be acceptable. In this study, it is anticipated that the random effects technique will hold true for the provided data set. Here are the estimated outcomes of the Hausman test:

6.2 Hausman Test

The Hausman test (1978) offers clear guidance on how to select between fixed effects and random effects methods. The Hausman test was used to adjust whether panel method is appropriate for this investigation after many panel tests, such as panel least square, fixed effects, and random effects models, were run. As a result, the study anticipates that the random effects approach will hold true for the provided data set. As a result, the predicted Hausman test results are provided below:

Table 5. Operational Result of Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f	Prob.
Cross-section random	28.191258	9	0.4289

Source: Annual Reports (2013-2022)

Note: a) Data have been compiled by Researcher

b) Data extracted from analyzing information on STATA

The operational findings of the Hasuman test are highlighted in Table 5, where the degree of freedom is 9 and the test's Chi-square value is 28.191258. The test's p-value, which is greater than 0.05 percent, is 0.4289. As a result, the random effects technique's null hypothesis is accepted, meaning that method is appropriate for the study.

Table 6. Operational Results of Random Effect Model

Variable	Fixed Effects Model			
	Co-efficient	Std. Error	t-statistic	p-value
Constant	0.780118	0.489317	1.594301	0.1128
RCP	-0.027788	0.022209	-2.251178	0.0227
ICP	-0.009079	0.235797	-3.038503	0.0093
PDP	0.035515	0.017771	0.077713	0.1793
CCC	-0.095925	0.105883	-2.905955	0.0363
R-square.	0.353521			
Adjusted R-squared.	0.297111			

Source: Annual Reports (2013-2022)

Note: a) Data have been compiled by Researcher

b) Data extracted from analyzing information on STATA

Table 6 displays the capacity of predictors to explain the profitability of Bangladesh's textile sector. Payable deferral period is not more significant for company performance as a model specification variable. The performance of the company is significantly impacted by the cash conversion cycle, receivable collection period, and inventory conversion time. The amount of time needed to recover money from debtors has a harmful influence on the productivity of the company. The number of days needed to transform raw materials into finished goods and then generate revenue is inversely correlated with the performance of the firm, as is the time needed for cash conversion. The dependent variable is explained by the independent variable by 29.71% when the adjusted R-squared value is 29.71%. Several elements could influence how well Bangladesh's textile businesses perform.

7. Key Results and Recommendations

It was establish that the cash conversion cycle, receivable collection time, and inventory conversion duration were the working capital factors influencing an organization's success. The length of the payable deferral period was not found to be a main factor in describing the profitability of Bangladesh's textile manufacturers. Therefore, it is advised that the policy makers of Bangladesh's textile industries place more emphasis on collecting receivables from the company's creditors and shorten the period it takes to transform raw materials into finished goods. This will shorten the cash conversion cycle and increase the profitability of Bangladesh's textile industries.

8. Conclusion

The Bangladeshi economy is heavily reliant on the textile industry. In order to maintain the health of this industry, proper working capital management is essential. Any company can achieve an appropriate cash conversion cycle, which is a appropriate indicator of firm performance, by reducing the inventory conversion time, increasing the payable deferral time, and shortening the receivable collection period.

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