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Analysis of The Effect of Working Capital Management on Profitability In Manufacturing Companies In Indonesia

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Abstract: This study aims to analyze the effect of working capital management on profitability in manufacturing companies in Indonesia. The method employed is a literature review by examining five related scientific journals. The findings indicate that efficient working capital management, particularly through the management of the Cash Conversion Cycle (CCC), has a positive impact on company profitability. Components such as receivables, inventory, and payables management play a crucial role in enhancing operational efficiency and liquidity, ultimately leading to improved profitability. Optimal working capital management enables companies to maximize Return on Assets (ROA) as an indicator of financial performance efficiency. These findings provide insights for companies to improve working capital management to achieve financial stability and sustainability.

Keywords: Working Capital Management, Profitability, Cash Conversion Cycle, Return on Assets (ROA), Manufacturing Companies

Introduction

The company as a business entity has the main objective of obtaining sustainable profits or profits. Company performance can be evaluated through financial reports generated from data compiled regularly by management. In the study of corporate finance literature, attention is often focused on long-term financial decision making, such as investment, capital structure, dividend policy, and evaluation of other strategic decisions. However, the management of short-term assets and liabilities also plays an important role, especially through working capital management which can affect the company's profitability. Working capital management, which involves managing receivables, inventory, and payables, plays a key role in maintaining the company's liquidity balance and operational efficiency (Gitman, 2022). Working capital is one of the important elements in the management of corporate finance, which is defined as the difference between the total current assets and the company's short-term liabilities (Al-Dhubaibi, 2024). Current assets, which are dynamic and can usually be converted into cash in less than one year, include cash, receivables, inventory, and securities. Meanwhile, short-term liabilities include trade payables, short-term loans, and other liabilities that must be settled within a one-year period. Working capital plays an important role in supporting the smooth operation of the company, especially in meeting urgent financial obligations (Dewi & Wisadha, 2015). There are two types of working capital, namely gross working capital and net working capital.

Gross working capital refers to the total current assets of the company, while net working capital is calculated by subtracting current liabilities from total current assets. Good management of working capital will allow the company to meet operational needs without facing short-term financial difficulties, which ultimately contributes to the stability and profitability of the company (Ardiansah & Wahyudi, 2022). Working capital management involves managing a company's current assets and current liabilities efficiently to maintain liquidity and operational smoothness. One of the main ways to measure the effectiveness of working capital management is by using the Cash Conversion Cycle (CCC). The cash conversion cycle reflects the time required by a company to convert investments in inventory and receivables into cash. Good working capital management, by shortening this cycle, can increase liquidity and support the growth of company profitability (Sapetu et al., 2017). The cash conversion cycle consists of three main elements: Days Inventory Outstanding (DIO), Days Sales Outstanding (DSO), and Days Payable Outstanding (DPO). CCC calculation is done by adding DIO and DSO, then subtracting DPO (Koroma, 2024). Companies that have a fast cash conversion cycle tend to have a healthier cash position, which has the potential to increase their profitability (Suryaputra & Christiawan, 2016). This shows that efficient working capital turnover is directly related to optimal cash management. Efficient working capital management can affect the profitability of the company. Well-managed working capital will ensure smooth operations, allowing the company to meet short-term obligations and take advantage of growth opportunities. In addition, efficient working capital management can also increase the company's liquidity, allowing the company to invest in profitable projects (Dewi & Wisadha, 2015).

Ardiansah and Wahyudi (2022) and Putra and Sari (2017) found that companies with better working capital management tend to have higher levels of profitability. This is in line with the findings of Sapetu et al. (2017) which show that companies with faster cash conversion cycles can increase net profit margins and ROA.

Overall, optimal working capital management, by minimizing the time required to convert assets into cash, has a positive impact on a company's profitability, which is an important indicator of long-term financial success. Therefore, this study aims to analyze the effect of working capital management on profitability in manufacturing companies in Indonesia, focusing on the effect of the cash conversion cycle and its components on profitability ratios such as ROA (Hariyati, 2019).

Financial statement analysis provides important information about the strengths and weaknesses of a company, and allows for an assessment of financial productivity that supports smooth business operations. One of the indicators used to assess financial performance is the level of profitability, which shows how efficient a company is in generating profits from its operational activities. Good profitability reflects management's ability to plan working capital needs appropriately and efficiently. Optimal working capital is essential to support smooth company operations, especially in financing assets that support business activities. According to Brigham and Ehrhardt (2023), good working capital management will reduce financing costs and increase the company's long-term profitability (He, 2017).

Working capital management aims to achieve an optimal balance between current assets and current liabilities. The success of a company in achieving this goal depends on the ability of financial management to manage working capital components efficiently. Controlled receivables, optimal inventory, and well-managed debt will minimize costs and maximize profits. This study aims to analyze the effect of working capital management on profitability in manufacturing companies in Indonesia, with the hope of providing insight into how working capital management can affect a company's financial performance (Salehi, 2022).

Methodology

This study uses a traditional literature review method by collecting and analyzing relevant literature. The literature sources used include scientific journals, reference books, articles, theses, and various other information that supports the research topic. The literature study process is carried out through several stages. First, a search for journals related to the topic of working capital is carried out using the Publish or Perish (PoP) application (Saadat, 2016). Furthermore, a search is also carried out through Google Scholar with a combination of keywords such as " Working Capital " in the title words column and "Profitability" in the keywords column. The initial search results are saved into a list of articles, then selected into five relevant articles for further analysis. Analysis of these journals includes a review of research results and related discussions (Hendayana, 2021). Finally, this study concludes that there is a positive influence between Cash Conversion Cycle (CCC) and Return on Asset (ROA) on the dependent variables studied.

Result and Discussion

The results of the literature review conducted show various findings related to the influence of working capital management on company profitability. Teguh Ardiansah and Ickhsanto Wahyudi's (2022) research entitled The Influence of Working Capital Management on Company Profitability found that Days Sales of Inventory (DSI) had a positive and significant effect on the profitability of automotive sub-sector companies listed on the Indonesia Stock Exchange (IDX) for the 2015-2019 period. However, Days Sales Outstanding (DSO) and Days Payable Outstanding (DPO) had a negative and significant effect on profitability in the same sector. Ni Made Rustia Dewi and I Gede Supartha Wisadha (2015) in a study entitled The Influence of Working Capital Management on Manufacturing Company Profitability showed that the average receivables collection time (ACP), inventory turnover period (ITID), and average debt payment time (APP) had a negative impact on company profitability (Oh, 2023).

Gladys Suryaputra and Yulius Jogi Christiawan (2016), through a study entitled The Effect of Working Capital Management, Sales Growth, and Company Size on Profitability , revealed that sales growth (SG) has a significant effect on Return on Assets (ROA) . However, Cash Conversion Cycle (CCC) and company size (SIZE) do not have a significant effect on ROA in property and real estate companies on the IDX for the period 2010-2014.

Edisah Putra and Rindy Antika Sari (2017) in the study of Working Capital Management Analysis in Increasing Profitability at PT Perkebunan Nusantara III showed that working capital management has not been effective in increasing the company's profitability. Total asset turnover is not efficient in supporting profitability, while debt management through the Debt to Asset Ratio (DAR) is considered productive even though it has decreased. Research by Made Sri Utami and Made Rusmala Dewi S (2016) entitled The Influence of Working Capital Management on Manufacturing Company Profitability concluded that cash turnover, receivables, and inventory have a positive and significant influence on company profitability. Working capital management is an important aspect in corporate financial decision making, especially for short-term policies that affect financial performance. In general, the results of the studies reviewed indicate that efficiency in managing receivables, inventory, and cash cycles has a significant contribution to increasing corporate profitability. However, the impact of certain variables may vary depending on the industry sector and research context (Fernández-López, 2020).

Discussion

Working capital management is an important element in corporate financial management that aims to maintain a balance between current assets and short-term liabilities. Efficiency in working capital management has a direct impact on the company's ability to increase profitability (Saudi, 2019).

The results of the reviewed studies show that several components of working capital management, such as Days Sales of Inventory (DSI) , Days Sales Outstanding (DSO) , and Days Payable Outstanding (DPO) , have a significant effect on profitability. In the study of Teguh Ardiansah and Ickhsanto Wahyudi (2022), DSI has a positive effect on profitability, indicating that effective inventory management can increase company profits. However, DSO and DPO have a negative impact, indicating that delays in collecting receivables or paying debts can hamper cash flow and reduce profitability.

Other research results, such as those conducted by Ni Made Rustia Dewi and I Gede Supartha Wisadha (2015), emphasize that longer receivables collection periods and inventory turnover have a negative impact on profitability. This emphasizes the importance of fast and efficient management of receivables and inventory to maintain the company's financial stability. However, research by Gladys Suryaputra and Yulius Jogi Christiawan (2016) shows that Cash Conversion Cycle (CCC) does not always have a significant impact on profitability, especially in property and real estate companies. This indicates that certain industrial sectors have different working capital management dynamics, where other factors such as sales growth (SG) are more dominant in determining profitability (Jahfer, 2015).

On the other hand, research by Made Sri Utami and Made Rusmala Dewi S (2016) highlighted that cash turnover, receivables, and inventory consistently have a positive effect on profitability in manufacturing companies. This shows that the manufacturing sector is more sensitive to efficient working capital management compared to other sectors. In general, the results of this study emphasize the importance of implementing working capital management strategies that are tailored to the characteristics of each industrial sector. Factors such as cash cycles, accounts receivable management, and inventory control must be optimized to achieve maximum results. The differences in the influence of working capital management variables also provide insight that a flexible and contextual approach is needed in facing financial challenges in various sectors.

Conclusion

Based on the research results, efficient working capital management is generally proven to increase company profitability. These results reflect that the management of working capital components, such as receivables, inventory, and cash cycles, plays a strategic role in improving financial performance. Specifically, the research results show:

1. Accounts Receivable Management: Efficient accounts receivable control can accelerate cash inflow, thereby increasing liquidity and supporting profitability.
2. Inventory Management: Optimal inventory turnover helps companies avoid excess storage costs and minimizes the risk of obsolescence, which has a positive impact on profitability.
3. Cash Conversion Cycle (CCC): A shorter cash cycle indicates a company's ability to manage its operational activities effectively, thereby strengthening financial performance.

However, research also shows that the effect of working capital management on profitability can differ between sectors, depending on the business characteristics and operating environment of each company. Therefore, working capital management strategies need to be tailored to the specific needs and conditions of the company to achieve optimal results .

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