The Relationship between Working Capital Management and Profitability

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Abstract

Purpose – The purpose of this paper is to investigate the relationship between working capital management and profitability for a sample covering industrial firms in five European countries.

Design/methodology/approach – In this research, we have selected a sample of 329 industrials European firms for the period 2003-2010. We have studied the effect of cash conversion cycle and its components on the gross operating profitability, using panel data econometric methodology.

Findings – Using robust estimation techniques, the results of this research showed that in most countries there is a significant negative relation between gross operating income and the number of days for accounts receivable, inventories and accounts payable. These results suggest that managers can create value and improve firm’s profitability by shortening the cash conversion cycle.

Originality/value – This study avoids the traditional approach on corporate finance which focused on the study of long-term financial decisions. The paper contributes to the literature by analyzing the effects of management in short-term assets and liabilities through the working capital management and its components. Additionally, for the first time, we investigate these effects through a sample within five European countries.

Keywords Working Capital, Profitability, Cash Conversion Cycle, Europe, Inventories, Accounts Receivable and Payable, Working Capital Management.

Paper type Research paper

JEL classification - M16, M41

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