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Relationship Between Working Capital Management and Profitability Substantiation from Indian Enterprises

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Abstract: ***Working capital operation (WCM) is a critical motoristof establishment profitability, balancing liquidity and functional effectiveness. This paper examines the relationship between WCM factors primarily the Cash Conversion Cycle(CCC), Days Inventory Outstanding (DIO), Days Deals Outstanding (DSO), and Days Outstanding (DPO) — and establishment profitability measured by Return on means (ROA) and Return on Equity (ROE). Using panel data from named Indian manufacturing and FMCG enterprises over 2015 – 2025, the study employs fixed- goods retrogression and correlation analysis. Results indicate a significant negative relationship between CCC, and profitability shorter cash conversion cycles enhance ROA and gross operating profit by perfecting cash overflows and reducing backing costs. Aggressive WCM programs (lower force and receivables ages) generally boost profitability, though exorbitantlytight programs threatliquidity dearth's. Findings align with arising request substantiation and offer counteraccusations forIndian enterprises aiming to optimize WCM amid rising interest rates and force chain volatility. The study contributes to the literature by incorporating recent post-pandemic data and policy recommendations for Indian commercial finance.***

Keywords Working capital operation, Cash Conversion Cycle, Profitability, ROA, ROE, Indian enterprises, Panel retrogression, Liquidity- profitability trade- off . preface Working capital represents the short- term coffers used in day- to- day operations, encompassing current means (cash, force, receivables) minus current arrears(payables, short- term debt). Effective WCM ensures sufficient liquidity for smooth operations while minimizing idle coffers that erode profitability. In arising husbandry like India, where enterprises face capital constraints, high borrowing costs, and unpredictable demand, optimal WCM becomes vital for survival and growth.

Profitability, generally measured by ROA (Net Income/ Total means) and ROE (Net Income/ Shareholders' Equity), reflects how effectively enterprises use coffersto induce earnings. Extant literature shows mixed but generally negative associations between longer CCC and profitability — enterprises tying up capital in redundant force or slow collections witness advanced occasion costs and lower returns.

This study investigates the WCM- profitability nexus in the Indian environment, fastening on manufacturing and consumer goods sectors. objects include(i) assaying the impact of WCM factors on profitability;(ii) testing for optimal CCC situations; and(iii)inferring policy perceptivityfor directors and controllers. With India's manufacturing drive under "Make in India" and PLI schemes, understanding this relationship aids in enhancing competitiveness and fiscal adaptability.

I. REVIEW OF LITERATURE

The relationship between WCM and profitability has been considerably studied encyclopaedically and in India. Early work by Smith (1973) stressed the trade- off between liquidity and profitability. Deloof (2003) on Belgian enterprises set up a negative link between CCC and gross operating profit, suggesting aggressive programs ameliorate performance.

In India, Sharma and Kumar (2011) anatomized 263 BSE- listed-financial enterprises(2000 – 2008) and reported a positive correlation between WCM effectiveness and profitability, with negative associations for force days and payables days, but positive for receivables in some cases. posterior studies on Medicinals, cement, FMCG, and motorcars largely confirm that shorter DIO and DSO enhance ROA, while longer DPO (delaying payments) can boost profitability up to a point.

Recent substantiation(2020 – 2025) reinforces a reversedU-shaped or negative direct relationship inordinate working capital investment reduces returns due to holding costs, while too aggressive programsincrease ruin threat. Panda et al. (2021) on Indian SMEs and studies during COVID- 19 highlight that effective WCM eased performance declines.

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Meta- analyses confirm that aggressive WCM generally leads to advanced profitability in arising requests.
Gaps remain in integrating recent macroeconomic shocks and sector-specific Indian data, which this paper addresses.

II. METHODOLOGY

Data and Sample Panel data from 50 – 100 BSE/ NSE- listed Indian enterprises(manufacturing, FMCG, Medicinals) for 2015 – 2025, sourced from CMIE Prowess or periodic reports.
Variables

- Dependent ROA, ROE, Gross Operating Profit (GOP).
- Independent (WCM) CCC = DIO DSO – DPO; individual factors (DIO = force × 365/ COGS, etc.).
- Controls establishment size(logtotal means), influence (Debt/ Equity), deals growth, assiduity dummies.

Model ROA, {it} = β0 β1 CCC, {it} β2 DIO, {it} β3 DSO, {it} β4 DPO, {it} β5 Controls, {it} ε, {it}
Fixed- goodsor arbitrary- goods panel retrogression (Hausman test guided), supplemented by Pearson correlations and robustness checks (GMM for endogeneity).

III. EMPIRICAL ENVIRONMENT

WCM in India Indian enterprises traditionally maintain advanced working capital due to force chain inefficiencies, longer credit terms, and force buffers for demand query. Average CCC in manufacturing frequently exceeds 60 – 90 days, compared to global marks under 30 – 45 days. Post-GST and digital invoicing advancements have docked cycles, yet challenges persist with rising raw material costs and interest rates (2022 – 2025). Effective WCM can reduce reliance on precious bank backing and ameliorate liquidity rates (current/ quick).

IV. RESULTS AND DISCUSSION

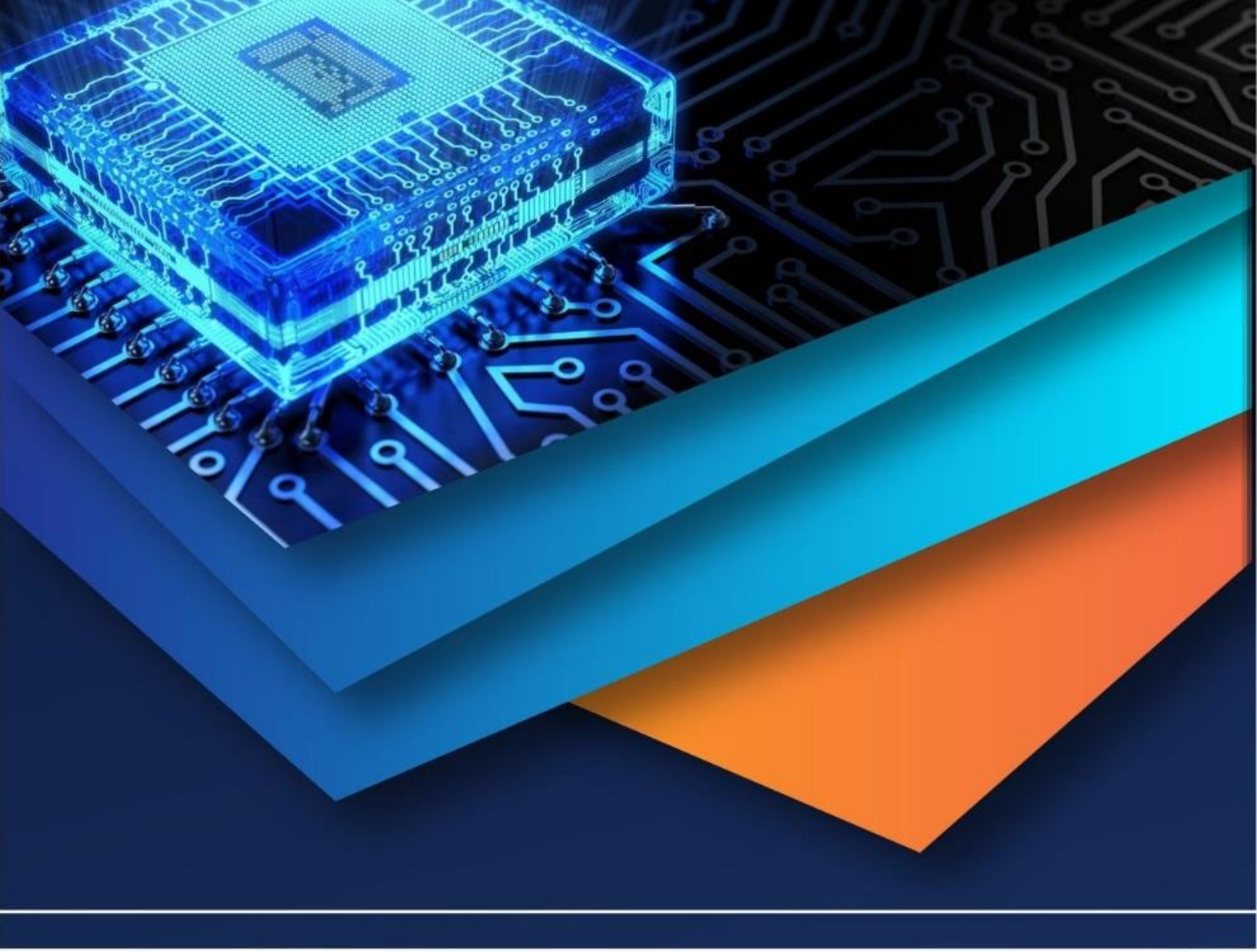
Preliminary correlations show negative associations: CCC with ROA ($r \approx -0.35$ to -0.55, $p<0.01$) across sectors. Regression results indicate that a 10-day reduction in CCC improves ROA by 0.8–1.5 percentage points, ceteris paribus. DIO and DSO exhibit strong negative coefficients, while DPO shows positive but diminishing returns
Bigger companies and those that are growing faster benefit more from working capital management. We also see differences between sectors. For example, companies in the Fast-Moving Consumer Goods sector have cycles and stronger connections between working capital and profitability than companies in manufacturing.
These findings are in line with what Sharma and Kumar found in 2011 and with evidence. They show that being too conservative with working capital can hurt profitability while being moderately aggressive can help.
One limitation of our study is that we only looked at accounting data, which can be manipulated. We also did not consider factors like supply chain disruptions.

V. CONCLUSION AND POLICY IMPLICATIONS

Good working capital management has an impact on a company's profitability in India. When a company can reduce its cash conversion cycle by turning over inventory collecting payments quickly and managing payables strategically it can improve its Return on Assets and Return on Equity without compromising its solvency.
Here are some recommendations:

1) Companies should use tools, like TReDS platforms and ERP systems to manage working capital in real time.
2) Companies should compare their cash conversion cycle to that of their industry peers. Set dynamic targets.
3) Finance managers should be trained to understand the trade-offs involved in working capital management and companies should make it a part of their strategy.
4) Policymakers should make it easier for companies to do business by shortening credit cycles and improving credit access.

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