



Liquidity Management and Profitability of Textile Sector of Pakistan

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ABSTRACT

Liquidity management is critical for a company's financial management and profitability. This study intends to analyze the effect of liquidity management on the functioning of 15 companies from the textile sector listed at the Pakistan Stock Exchange (PSE) for five years. The secondary data was obtained from the annual reports of these companies. Correlation and regression analysis were applied for data analysis. The results reveal that the current ratio and creditor payment period have a negative and considerable effect on the return on assets (ROA). In contrast, the quick ratio and inventory sales period positively correlate with profitability (ROA). Yet, the debtor collection period has a worse and exceptional impact on the firms' profitability. As a result, it is suggested that the textile industry in Pakistan should consider liquidity management as an important tool to increase profitability.



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1. Introduction

Liquidity management is critical for a company's development and profitability. In order to avoid insolvency and eventual bankruptcy due to poor financial performance, all businesses must meet the priorities of good liquidity management. Liquidity is a critical financial metric that determines whether or not a firm can fulfill its short-term obligations without suffering unfavorable losses. According to A Bhunia (2010), liquidity is critical to the effective operation of a business. A company should make sure that it has enough liquidity to satisfy its short-term needs. Furthermore, retaining extra liquidity is not advantageous because idle funds create no income or profits. It may be assumed that a well-managed company will neither have insufficient nor excessive liquidity.

Profit maximization is a short-term goal for a company, while maximizing shareholder wealth is a long-term and desired goal for all businesses. Liquidity risk, which occurs when a firm is unable to pay its present business obligations, might have a significant impression on the firm's profitability (Jenkinson, 2008). It happens as a result of inadequate liquidity management and occasionally unfavorable market conditions. It occurs as a result of inadequate liquidity management and, on occasion, a bad economic scenario. Misalignment of current assets and obligations can also generate liquidity issues, leading to a severe liquidity crisis (Goodhart, 2008).

The consequence is that while businesses with high liquidity may have minimal liquidity risk, maintaining more assets in liquid form may impede excellent investment initiatives due to the reduction in funds the firms accept a loss. On the other hand, firms may have trouble managing day-to-day operations if they invest all of their capital in profit-

generating ventures. It should be emphasized that to run a business sustainably, competently, and efficiently, liquidity and profitability trade-off management is required. As a result, to ensure long-term commercial success, a company must pursue an ideal balance of liquidity and profitability and maintain its position around that level. Liquidity management guarantees that the company can pay its present commitments, while profitability management ensures that it can generate income that exceeds its costs.

One of the critical factors that may lead to the liquidation of a company is a lack of talent and a sufficient profit. These are some of the most important factors to consider when assessing a business's "going concerned." As a result, companies are devising a variety of ways to enhance their liquidity situation. The administration of working capital, which is often overlooked in the situation of favorable economic time, is one of the strategies that may be used inside the organization to increase liquidity and cash flows (Azam, Nawaz, & Riaz, 2019; Hashmi, Ahmad, & Nawaz, 2021; Shafiq & Gillani, 2018). This research aims to focus on the link between liquidity management and profitability in Pakistan's listed textile sector.

The study's primary goal is to determine the influence of liquidity management on Pakistan's textile industry's profitability. (1) To find out the impact of the current ratio on profitability. (2) To find out the effective management of quick ratio on profitability. (3) To investigate the impact of debtors' collection period on profitability. (4) To observe the impact of the creditor payment period on profitability. (5) To find out the impact of the inventory sales period on profitability.

Liquidity is critical to the smooth operation of a business. To satisfy its short-term compulsions, a company should ensure that it does not suffer from a shortage of or excess liquidity. Because of its close link with a company's day-to-day operations, a study of liquidity is significant to both internal and external experts. These circumstances force corporate executives to devise various techniques for managing internally produced income to increase their chances of generating a profit and fulfilling current shareholder expectations (Maqbool, Razzaq, Ul Hameed, Atif Nawaz, & Ali Niaz, 2019; Mirza, Abbas, & Nawaz, 2020; Noshad, Amjad, Shafiq, & Gillani, 2019). In terms of development, survival, sustainability, growth, and performance, liquidity management and profitability are critical (Haq, Nawaz, Mahtab, & Cheema, 2012; Yang & Shafiq, 2020). This study aims to determine the connection between both liquidity and profitability in Pakistan's textile sector.

2. Literature review

Effective liquidity management helps organizations achieve increased profitability by decreasing their input demands and ensuring their existence. In addition, it provides strategic advantages during economically challenging times (Bhatti, Farhan, Ahmad, & Sharif, 2019; Bhatti & Nawaz, 2020; Haq et al., 2012; Shafiq, Hua, Bhatti, & Gillani, 2021). Effective liquidity management in corporate organizations has always been critical to the smooth operation of the company (Kamran, Qaisar, Sultana, Nawaz, & Ahmad, 2020; Khan, Nawaz, & Hussain, 2011). Liquidity management, which is more critical than specified in the financial management section, is the most challenging component of small business financial management (Tarnoczi, Fenyves, & Voros, 2014). As a result, liquidity management has become a fundamental and comprehensive part of the business. They are assessing the performance of a business. The cash conversion cycle illustrates the link between liquidity and profit. When a corporation uses the current ratio, it is more necessary to measure profitability. Significantly, in these works, The results revealed a negative link between liquidity management and profitability (A Bhunia & Brahma, 2011).

Here are the strategies help to process liquidity in business association. By using the ratio analysis, you can determine how liquid the firm is. To discover a proportion of current resources for current liabilities is by current proportion. The speedy proportion will allow realizing whether they can dispense their present obligation, prohibit selling any stock. It's anything but an association to worry about this because if they need to sell a stock, they also need a client to purchase that stock (Ghosh, Singh, Inamdar, Mote, & Chakraborty, 2009).

The mandatory liquidity for every firm is entirely or partially dependent upon the balance sheet condition of the company. To assess the liquidity state, particular importance is held on how there are classified organizational assets and liabilities (Basno & Dardac,

2004). Operating cash flows created by assets will influence the tall liquidity of the company. It's not just because of the liquidation value. Businesses with much less liquidity may have difficulties sustaining business, but those with excess existing assets will suggest that cash flows are not ideal (Van Horne & Wachowicz Jr, 2000).

Although liquidity risk is seen as a significant danger, it is the subject of excessive liquidity, "security cushion," or the specialization of mobilizing money at "normal" costs (Dedu, 2003). Liquidity lines and financing facilities may also play a role in an institution's liquidity plan by protecting itself against temporary challenges in meeting cash outflow commitments. Amalendu Bhunia, Khan, and MuKhuti (2011) Investigated the efficiency of Indian steel businesses' liquidity management with a sample of 230 enterprises over nine years (2002-2010) and discovered a slight correlation between liquidity and profitability measures (ROCE).

The liquidity amount, quick ratio, current assets, and profit margin are positive and substantial. These parameters thus have a major influence on the development in the performance of European companies in the f&b industry for the timeframe 2010-2012 of IDX (Khalidun & Muda, 2014). Raheman and Nasr (2007) researched Pakistani businesses and found similar findings, namely, a substantial negative relationship between liquidity or working capital and profitability.

The current ratio is also known as the total amount of an organization's liquidity. The link between existing assets and current liabilities is used to calculate liquidity ratios. Current assets are liquid assets that can be used to meet short-term obligations. Cash, debtors, loans, current investments, inventories, advances, and prepaid expenses are all considered. Liabilities that are projected to mature within a year are referred to as current liabilities. The current ratio, which is a liquidity ratio, can pay current liabilities with cash earned from existing assets. Current assets are divided by current liabilities to arrive at this figure (Chandra, 2008).

This evaluates a firm's capacity, utilizing close to funds or fast investments, to immediately eliminate or remove existing debts. This ratio includes by far the most liquidity profits and losses. The increased value of this ratio shows the significant liquidity of the firm. This fraction doesn't seem to include prepaid costs and stocks as it is possible to decipher into currency (Sinha, 2012).

Revenues show how strong leadership is performing with investment and funding decisions like no other accounts measure. Multipliers in profitability assess how well a company manages sales earnings, total assets, and, most significantly, investors' participation. Someone who has a tool that supports long-term survival will thus be interested in profitability ratios (Moyer, McGuigan, & Rao, 2014). A favorable link between the period of trade payables and profitability for companies in the USA. According to research, the good and negligible correlation of liquidity and profitability includes (Hussain, Hamid, Imdad Akash, & Imdad Khan, 2011).

After Analyzing the significant impression of Working Capital Management on the SME's Profitability in our country, we came to the point that the indicators of the concerned management, which were Inventory Conversion Period, Cash Conversion Cycle, Receivable Collection Period, and Payable Deferral Period, had an incredible impact on profitability which was calculated by the return on assets of firms after a thorough research. After calculating the correlation among firms' profitability and CCC in seven different industry groups in more than twenty years from 1974 to 1993. It has been observed in several branches of industry, for instance, mineral wealth, industry, service, retail and wool selling, as well as professional services, that effective operating capital management is related with better profitability, but is also not connected with all businesses.

Based on this justification, we hypothesized a more plausible non-linear connection between the productive capital of a company and revenue. In particular, the link is significantly favorable to the businesses experiencing poor working capital and for those companies in the hotel industry that have a good workflow. The findings of earlier research such as (Basno & Dardac, 2004).

On the evaluation of the relationship among Indian pharmaceutical companies' profitability and working capital of the country. There are different opinions on this: as per one opinion, working capital has never been a factor for enhancing profitability, there might be the worst relationship among them as well, on the other hand, according to the second opinion, investment in working capital has a major part in improving profitability. Moreover, unless there is the lowest financing of working capital is noticed, both sales and output can never remain the same. The inability of this sector would have fixed assets inoperative (Chakraborty, 2008).

This ratio (ROA) tells you what the business can do using its essential assets, for instance, the total profit they get from the personal assets they control. It's a valuable amount if you wish to compare competing companies in one firm. Although, these calculated ratios never remain the same across other industries. The assets represent the capital intensity of the concerned firm, depending on the industry; companies that mandate initial investments generally have a lot less return on assets. A good ROAs ratio is somewhere over 5%; this is exceptionally significant.

Deloof (2003) discovered that businesses might improve their profitability by decreasing the total stock of debtor duration and the days-in-inventory time. Additionally, he discovered that less successful businesses take forever to spend their mortgage. Wang (2002) examined a sample of not only Taiwanese but Japanese businesses as well. Moreover, got a shorter currency flow period.

Narasimhan and Murty (2001) emphasized the need of many sectors to increase their financial leverage (ROCE) by concentrating on a few critical areas for cost reduction to increase working capital efficiency. Indeed, the majority of empirical research tends to show efficient functioning. Even though most of this research focuses on non-financial companies, the hedge fund directly impacts company profitability. More precisely, the majority of studies believe that reducing the currency conversion cycle increases company ROA. In other words, although decreasing stock turnover and debtors' collection period increases company profitability, decreasing creditors' payment time is seen as harmful to firm performance.

H₁: There is a prominent positive correlation between the Current Ratio and ROA.

H₂: There is a prominent positive correlation between Quick Ratio and ROA.

H₃: The Debtors Collection period and ROA are considered unfavorable.

H₄: The Creditor Payment Period ROA has a strong negative connection.

H₅: Inventory sales period ROA has a substantial positive connection.

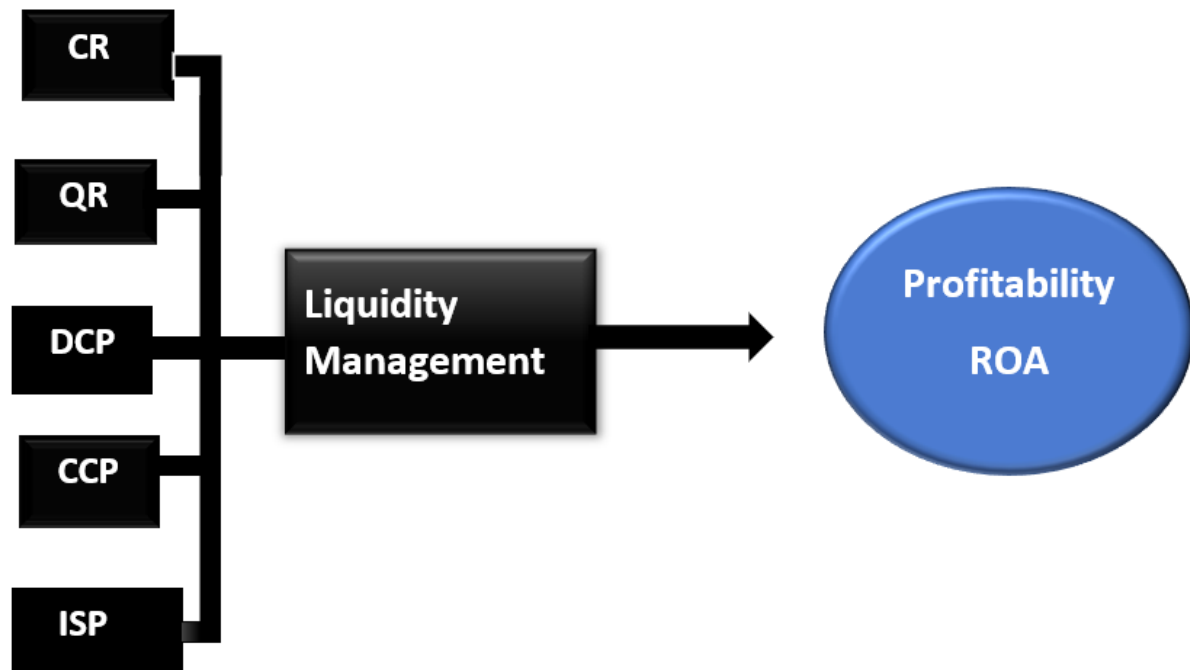


Figure 1:

CR: Current Ratio, QR: Quick Ratio, DCP: Debtors Collection Period
 CPP: Creditor Payment Period, ISP: Inventory Sales Period, ROA: Return on Asset

3. Methodology

The present research is descriptive and emphasizes studying a situation or a problem to explain the relationship between variables. The sample of this study is composed of listed Textile Sector at Pakistan Stock Exchange between 2015 and 2019. The scope of the study is listed Textile Sector Stock Exchange Pakistan. One hundred twenty-nine firms are currently listed under different Textile sectors. In the current study, out of 129 companies, only 15 are officially listed for the research purpose randomly.

Table 1
List of Companies

List of Companies		
1	Azgard Nine Ltd.	ANL
2	Yousaf Weaving Mills Ltd.	YWML
3	Indus Dyeing & Manufacturing Co. Ltd.	IDML
4	Bannu Woollen Mills Ltd.	BWML
5	Colony Textile Mills Limited	CTML
6	Fazal Cloth Mills Ltd.	FCML
7	Masood Textile Mills Ltd.	MTML
8	Quetta Textile Mills Ltd.	QTML
9	Sapphire Fibres Ltd.	SFL
10	Gul Ahmed Textile Mills Ltd.	GAME
11	Nishat Mills Ltd.	NML
12	Khyber Textile Mills Ltd	HTML
13	Feroze1888 Mills Ltd.	FML
14	Colony Textile Mills Limited.	CTML
15	Azgard Nine Ltd.	ANL

The study contains secondary data collected from the Financial Statements Analysis of Pakistan Stock Exchange of sample companies. The study's liquidity (independent) indicators are current ratio, quick ratio, Creditor Payment Period, Inventory Sales Period, Debtors Collection Period, whereas profitability (dependent) indicator is the return on assets.

$$ROA = f (CR, QR, DPP, CPP, ISP) \tag{1}$$

$$ROA_{it} = \beta_0 + \beta_1 CR_{it} + \beta_2 QR_{it} + \beta_3 DPP_{it} + \beta_4 CPP_{it} + \beta_5 ISP_{it} + \varepsilon_{it} \tag{2}$$

For comparison analysis, we will use Pooled / Panel Least square (POLS)

4. Results and Discussion

In table 2, the descriptive statistics of the variables, including mean, skewness minimum, standard deviation, maximum kurtosis, and median values, and the study used these descriptive statistics for further analysis.

Table 2
Summary Statistics

Variables	Mean	Min	Max	Std. Dev.	Skewness	Kurtosis	Median
ROA	.019	-.433	0.246	.099	-1.661	8.385	.033
CR	1.29	.141	5.376	.853	2.117	9.777	1.202
QR	.747	.113	2.473	.519	.991	3.657	.626
DCP	69.579	3.45	374.951	80.364	2.055	6.944	37.006
CPP	50.125	3.306	136.898	27.155	.755	3.777	47.093
ISP	102.767	5.674	424.133	85.201	2.125	7.94	83.763

The nature of the connection between various variables is revealed through a correlation matrix. Connection ratios between 0 and 0.30 indicate a weak correlation, 0.30 to 0.49 indicate a mild high correlation, 0.50 to 0.69 indicate a high correlation, and 0.70 to 1.00 show a very high correlation. Between ROA and the Current ratio, there is a high positive correlation of 0.537. The value 0.680 shows a strong connection between both ROA and Quick Ratio.

Table 3
Matrix of Correlations

Variables	ROA	CR	QR	DPP	CPP	ISP
(1) ROA	1.000					
(2) CR	0.537	1.000				
(3) QR	0.680	0.815	1.000			
(4) DCP	0.394	0.234	0.550	1.000		
(5) CPP	-0.381	0.048	-0.231	-0.323	1.000	
(6) ISP	0.060	0.516	0.056	-0.041	0.508	1.000

The ROA and Debtor Collection Period have a moderately high solid correlation of 0.394. ROA and Bondholder Payment Period have a negative relatively high correlation of -0.381. ROA and Inventory Sales Period have a 0.060 positive connection, which is a minimal correlation. In table 4, the linear regression results are shown.

Table 4
Linear Regression

Variables	Coefficient	Std. Err	t	Prob.
CR	-0.7414	0.0366	-2.02	0.047
QR	0.2298	0.0585	3.93	0.000
DCP	-0.0002	0.0001	-1.75	0.085
CPP	-0.0015	0.0003	-4.04	0.000
ISP	0.0006	0.0002	2.87	0.005
C	-0.2430	0.0228	-1.06	0.291
Model Diagnostics				
R-Square				0.5711
Prob > F				0.000
Root MSE				0.0673
Number of Obs.				75

The significant values of every variable in table 4 are less than (0.05), indicating that each affects the flow of foreign direct investment. The first variable is the Current Ratio, which has a significance value of (0.047), which is lower than (0.05), indicating that it affects the ROA. The variable current ratio has a Beta value of (-0.074), suggesting that it harms the flow of the ROA. The Quick Ratio is the following variable, with a significance value of (0.000), smaller than (0.05), indicating that it has the most effect on the ROA. While the variable's Beta value is (0.22), this indicates that this component has the most significant effect on the ROA. Creditor Payment Period has a significance value of (0.000) which is less than (0.05), indicating that it impacts the ROA. While the exchange rate's Beta value is (-0.0015), this

indicates that the Creditor Payment Period hurts the ROA. The Inventory Sales Period is a difference with a significant amount of (0.005), comparatively less than (0.05), indicating that the Inventory Sales Period affects the ROA. The variable's Beta value is (0.0006), indicating that the Inventory Sales Period affects ROA. However, DCP 0.10 is significant at the confidence interval level. The significance value of DCP is (0.085), which is smaller than the (0.10). The variable's Beta value is (0.028), indicating that the DCP affects ROA.

5. Conclusion

Appropriate profitability and effective liquidity management are critical to the successful supervisors of any firm to achieve the organization's tasks and achieve both short- and long-term objectives through long-term planning. Managing the trade-off between liquidity and profitability is a critical problem. Any organization must achieve optimal returns by maintaining a balance between profitability and liquidity. The goal of this research was to look at the seemingly divisive profit growth trade-off notion. The study discovered that the liquidity ratio has negative and positive effects on the Textile industries' profitability. Return on assets showed a negative and significant with current ratio. While DCP has a negative and significant impact on ten existing situations leave for the firms listed. While the quick ratio, and return on investment, and ROA are all positive relationships and significant.

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