

Assessment of Working Capital Management Practice: on the Case Study of Dire Dawa National Cement Factory

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Abstract

Efficient working capital management practice plays crucial role sustainability and profitability of the firm, particularly the emerging economic countries like Ethiopia. This study provides comprehensive Assessment on working capital management practice on Dire Dawa National Cement Factory. the study examines varies components of working capital management Through Ratio Analysis – liquidity ratio, Activity Ratio, Cash conversion cycle and cash management. besides this the study assess their impact on financial performance and liquidity of the company.

the study utilized mixed method approach. The analysis reveals a generally strong liquidity position, evidenced by improvements in the quick ratio from 0.7 to 0.91 and the current ratio from 1.44 in 2021 to 2.2 in 2023. However, the study identifies significant inefficiencies in credit collection and inventory management, as demonstrated by an increase in both the average collection period and inventory turnover days.

To address these challenges, the study recommends the implementation of stricter credit collection policies, the adoption of an efficient inventory management system, and the formalization of credit investigation and reorder level policies.

Keywords: Working Capital Management, Liquidity Ratio, Ratio Analysis, Activity Ratio, Cash Management

INTRODUCTION

Corporate finance often involves three important decisions: capital budgeting, capital structure, and working capital management. Capital budgeting and capital structure decisions are aimed towards managing long-term investments and financing. another side working capital management is emphases on short term financing as well as daily expance utilization on predetermined budget (Addin Al-Mawsheki, 2022).

Working capital is the firm's investment in current asset and their ways of financing in current asset. It is current asset used in operation and current liability used to finance. The difference between current asset and current liabilities is networking capital. The excess or shortage of networking capital has impact on the overall performance of affirm(Umenzekwe et al., 2024);(U Rohini, 2020),(Tariq & Raheelmumtazgufedupk, 2013). Proper working capital management is crucial to handling a business's

finances and determining the appropriate capital composition for operations and investments (Mengstie et al., 2024)

efficient utilization of working capital has significant impact on the company's success and failure. The main secret between successful and unsuccessful companies are the proper management of short term financing (Wassie, 2021)

further, the ultimate goal of any business origination's is the maximization of shareholders wealth, in order to line this goal which involves optimally employing the required resources to improve its financial performance (Jabbouri et al., 2024)

Working capital Management involves both setting working capital policy and carrying out that policy in day-to-day operation of the firm. It also involves decision and management of investment on current assets (Bhutto et al., 2019). It is against this background that this study seeks to examine the assessment of working capital management practices in Dire Dawa National Cement Factory.

Statement of the problem

Daily working capital management takes up the majority of the time and energy of chief financial officers in most businesses. Nevertheless, ineffective working capital management is a major factor in the failure of many firms since financial managers are unable to effectively plan and control the current assets and current liabilities of their organizations (Azzeddine & Ibrahim, 2021)

Working capital is unquestionably one of the most crucial components of any company's operation and is necessary to sustain the smooth operation of the business. Consequently, businesses may suffer losses as a result of inefficient working capital use, which also results in an inadequate pace of economic growth for the businesses (Amarasekara et al., 2021)

An organization experiences issues with profitability or liquidation when its working capital is poorly managed. While having surplus current assets on hand can help with solvency, it can also have negative effects on profitability and other opportunity costs. (Adewuyi, 2021)

Hereby, good working capital management practices can aid in reducing the cost of financing as well as the cost of maintaining current assets. By ensuring a sufficient amount of realizable cash, it prevents losses resulting from insufficient working capital. Also, it can aid in reducing technical insolvency. According to the researcher knowledge no study has been done in study area in the same topic. Therefore, the day-to-day activities failure in working capital management practice may result in inefficiency and ineffectiveness of the organization. To fill this gap the aim of current study is to analyze the working capital management Practices of Dire Dawa National Cement Factory.

Objective of the study

The main objective of the study is to Assess working capital management practice of Dire Dawa national Cement Factory

Research Methodology

Research Design

This study utilizes a descriptive research design to conduct an in-depth assessment of the company's working capital management practices. A mixed-method approach is employed, integrating both quantitative and qualitative data to provide a comprehensive analysis. Quantitative data are analyzed using ratio analysis to evaluate financial performance and efficiency.

Source of Data

The source of data for the study comprises both primary and secondary type of data. A Primary source of data was questionnaire and secondary data was the company's financial statements for the past three years.

Sample Size and Sampling Techniques

The total population of the study area was the employees of Dire Dawa National Cement Factory. There are 720 populations in the study area and the target population of the study was finance department. Thus, the study was selected 17 respondents from finance and management department by using census survey. From this the study was select 15 employees and 2 managers. Census survey method was enabling the researcher to collect relevant data from all the target population of the study

DATA ANALYSIS AND INTERPRETATION

As indicated in the earlier chapter, the main objective of this study was a study on the assessment of Working Capital Management Practice in Dire Dawa National Cement Factory. In order to achieve this objective, the specific research questions mentioned earlier need to be answered. So as to answer those questions, the researcher used both quantitative and qualitative methodology. In this chapter, the data were organized, as well as the results and discussions were presented. Three data gathering instruments were used. These were questionnaire and interview were interacted with the process of data interpretation and analysis. As a result, data obtained from questionnaire and interview were presented and discussed in an integrated manner. Discussion of the findings of the both groups of respondents was dealt with in a separate section for the sake of convenience.

4.1 Demographic Background of the Respondents

This section presents the background information with regards to the respondents’ age gender, and level of education. These aspects were put into consideration because of the meaningful contribution they offer to the study.

Table-1 Sex, Age, Marital Status and Educational Background of the Respondents

No	Questions	Options	Frequency	Percent %
1	Sex	Male	10	76.9
		Female	3	23.1
		Total	13	100.0
2	Age	26-35	10	76.9
		36-45	2	15.4
		>46	1	7.7
		Total	13	100.0
3	Marital Status	Married	10	76.9
		Single	3	23.1
		Total	13	100.0
4	Educational Background	Diploma	2	15.4
		Degree	10	76.9
		Master	1	7.7
		Total	13	100.0

Sources, own Survey

Table-1 shows that the respondent’s sex, in that 76.9 percent were male while 23.1 percent were females, an indication that indeed there are majority of male. As seen in table-1, 76.9 percent of the respondents were indeed married, while 23.1 percent were single. Table -1 revealed that majority of the respondents (15.4 percent) had Diploma, followed by 76.9percent who had Degree and university education

respectively. Additionally, 7.7 percent went to Master. It is expected that majority of the Respondents do not necessarily require formal education thus the low levels of education of the respondents.

4.2. Management of Accounts Receivable and Working Capital Management Practice

The study sought to examine the extent to which the management of accounts receivable affects working capital management practice in Dire Dawa National Cement Factory. The following subsection presents a detailed analysis of the findings with regards to how management of accounts receivables affects the working capital management practice.

Table-2 How did you finance your business initially?

Question	Options	Frequency	Percent %
How did you finance your business initially?	By borrowing from the Bank	13	100.0
	By borrowing from friends	-	-
	Self-financing	-	-
	Purchasing on credit	-	-
	Total	13	100.0

Sources, own

Respondent’s source of financing is presented in table-2, where all of the respondent 100% of the respondents borrowed money from the bank. This implies that indeed banks have been very instrumental in for starting business.

Table-3 Do you normally get cash target in advance for your business?

Question	Options	Frequency	Percent %
Do you normally get cash target in advance for your business?	Yes	12	92.3
	No	1	7.7
	Total	13	100.0

Sources, own Survey

Table -3, shows that the how the company has normally gotten cash target in advance for your business. Thus, the majority of respondents 92.3% respond that they normally get cash target in advance for their business. Beside to this 7.7% of the respondents were not agreed on the get cash target in advance for their business.

Table-4 Do you write down such estimates of cash requirement as a plan or budgeted document?

Question	Options	Frequency	Percent %
Do you write down such estimates of cash requirement as a plan or budgeted document?	Yes	10	76.9
	No	3	23.1
	Total	13	100.0

Sources, own Survey

Respondents were asked to state if they write down such estimates of cash requirement as a plan or

budgeted document. As seen in table-4, it is evident that majority of the respondents (76.9 percent) yes, while 23.1 percent said no. So, it indicates the company has estimate of cash requirement.

Table-4 How do you control the proceeds generated on a daily basis?

Question	Options	Frequency	Percent %
How do you control the proceeds generated on a daily basis?	Keep it in the Bank	12	92.3
	Spend the proceeds	1	7.7
	Total	13	100.0

Sources, own Survey

Table-4 shows reveals that 92.3 percent of the respondents save their money in the in the bank while the remaining 7.7 percent spend their proceeds. It is expected that most Dire Dawa National Cement Factory have cash proceeds and therefore they would prefer saving their proceeds in the bank.

Table-5 Do you spend within your budget?

Question	Options	Frequency	Percent %
Do you spend within your budget?	Yes	13	100.0
	No	0	0
	Total	13	100.0

Sources, own Survey

Table-5, shows that the how the company has spent within their budget. Thus, all the of respondents 100% respond that they spent within their budget.it reflects that the companies have good budget utilization.

Table-6 Do you normally record all cash transactions?

Question	Options	Frequency	Percent %
Do you normally record all cash transactions?	Yes	12	92.3
	No	1	7.7
	Total	13	100.0

Sources, own Survey

Table-6, shows that the how the company has normally gotten cash target in advance for your business. Thus, the majority of respondents 92.3% respond that they normally get cash target in advance for their business. Beside to this 7.7% of the respondents were not agreed on the get cash target in advance for their business.

Table-7 How often do you send money to the bank?

Question	Options	Frequency	Percent %
How often do you send money to the bank?	Daily	10	76.9
	Weekly	3	23.1
	Total	13	100.0

Sources, own Survey

Table 7 shows that the majority of respondents 76.9% responds that the company sends money to the bank daily. Beside on this 23.1% of the respondents were selected weekly.so it shows the company sends their money into the bank every day.it is very important to working capital control mechanism.

Table-8 How does the business invest its surplus cash?

Question	Options	Frequency	Percent %
How does the business invest its surplus cash?	In deposit account with commercial Bank	10	76.9
	In treasury security	3	23.1
	Total	13	100.0

Sources, own Survey

Respondents were asked to state the how does the business invest its surplus cash? As seen in table-8, it is evident that majority of the respondents (76.9 percent), in deposit account with commercial Bank, while 23.1 percent invest in treasury security. This is an indication that indeed Dire Dawa National Cement Factory does invest in deposit account with commercial Bank.

Table-9 The sources of your raw materials

Question	Options	Frequency	Percent %
What are the sources of your raw materials?	Local	1	7.7
	Foreign	1	7.7
	Both	11	84.6
	Total	13	100.0

Sources, own Survey

Respondents were asked to state the source of the raw materials for their business. As seen in table-9, it is evident that majority of the respondents (7.7 percent), get their raw materials locally, while 7.7 percent get them locally as the remaining 84.6 percent source for raw materials both locally and internationally. This is an indication that indeed Dire Dawa National Cement Factory does not heavily rely on foreign raw materials for their products.

Table-10 Experience a large pile-up of raw materials

Question	Options	Frequency	Percent %
Do you often experience a large pile-up of raw materials?	Yes	11	84.6
	No	2	15.4
	Total	13	100.0

‘Sources, own Survey

Respondents were asked to state if indeed they experience large pile of raw materials in their business. Table-10 shows that majority of the Dire Dawa National Cement Factory involved in the study (84.6 percent experience large pile up of raw materials in their business. This is an indication that indeed Dire Dawa National Cement Factory lack requisite inventory management tools that could be essential in the reduction of pile up of raw materials

Table-11 Keep records of goods or materials

Question	Options	Frequency	Percent %
Do you keep records of your goods or materials?	Yes	11	84.6
	No	2	15.4
	Total	13	100.0

Sources, own Survey

Respondents were further asked to state if they do have records of goods or materials in their business. Table-11 shows that 84.6 percent agree that indeed they keep records of goods and materials. It will be of interest to establish if indeed Dire Dawa National Cement Factory does stock taking as well as the frequency of stock taking by Dire Dawa National Cement Factory.

Table-12 Regular stock taken

Question	Options	Frequency	Percent %
Do you do regular stock taken?	Yes	12	92.3
	No	1	7.7
	Total	13	100.0

Sources, own Survey

Table -12 shows that indeed majority of the respondents (92.3 percent), do carry out stock taking except for 7.7 percent of the respondents who do not take stock further presents the frequency with which respondents were carrying out stock taking. As seen in the table 35% of the respondents carry out stock taking daily followed by 25% who carry out stock taking monthly and finally 40% percent do it yearly. This is an indication that indeed stock taking in Dire Dawa National Cement Factory is carried out very regularly given the nature of the business undertaken.

Table-13 Re-orders level policy for requesting stock or materials

Question	Options	Frequency	Percent %
Do you have a re-order level policy for requesting stock or materials?	Yes	12	7.7
	No	1	92.3
	Total	13	100.0

Sources, own Survey

Table 13 shows that majority of respondents 92.3% dire dawa national cement factory has no re order policy and 7.7% of respondents ignored that. But it reflects that the company has no re order policy to create moderate and quality stock.

4.3 Accounts Payable and Working Capital Management Practice

The study also sought to establish the extent to which the management of accounts payable affects working capital management in Dire Dawa National Cement Factory. This subsection will provide a detailed presentation of the findings on how accounts payable management influences working capital management practice. Other credit periods. Its indication dire dawa national cement factory has good collection period.

Table-14 Undertaking formal credit investigation before granting credit to your customers

Question	Options	Frequency	Percent %
Do you undertake formal credit investigation before granting credit to your customers?	Yes	3	23.1
	No	10	76.9
	Total	13	100.0

Sources, own Survey

As it's presented in table 14 76.9% respondents responds that dire dawa national cement factory has no formal credit investigation before granting credit to your customers and 23.1% respondents responds that the company have formal credit investigation before granting credit to their customers

Table-15 Procedures adhered to in investigating prospective credit customer

Question	Options	Frequency	Percent %
Are the following procedures adhered to in investigating prospective credit customer?	Check customers past records from other business firms	10	76.9
	Check customers past financial dealing with the company	2	15.4
	Check customers bank reference	1	7.7
	Total	13	100.0

Sources, own Survey

The analyses suggest that most Dire Dawa National Cement Factory investors had no credit extension policy in place to inform them about who should and who should not be given credit. It is for this reason that they opted for formal credit investigations procedures, which were inappropriate mechanisms to evaluate the credit worthiness of their customers.

Table-16. Evidence exists for a customer's indebtedness

Question	Options	Frequency	Percent %
What evidence exists for a customer's indebtedness?	Signing of delivery note or other receipts document	12	92.3
	Signing of formal IOU document	1	7.7
	Total	13	100.0

Sources, own Survey

Table 17 show that dire dawa national factory In granting credit to customers, there ought to be an evidence to suggest their indebtedness. (92.3 %) of them got their customers to sign delivery notes or other receipt documents. (7.7%) of the entrepreneurs ensured that their customers signed formal documents, while the remaining 7 (6.5%) respondents simply kept the names of their customers off hand.

Table-17 Giving cash discount to customers

Question	Options	Frequency	Percent %
Do you give cash discount to your customers?	Yes	12	92.3
	No	1	7.7
	Total	13	100.0

Sources, own Survey

As it's presented in table 17. revealed that majority of the respondents (92.3%), were in agreement that dire dawa national cement factory is sometimes give cash discount to customers to improve business cash flow and to reduce bad debts.

4.4 Management of Inventory Related Response

Table-18 Negotiate with creditors to extend the credit period

Question	Options	Frequency	Percent %
Do you negotiate with your creditors to extend the credit period?	Yes	11	84.6
	No	2	15.4
	Total	13	100.0

Sources, own Survey

In addition, table 18. 84.6 present findings with regards to the responses on how the Dire Dawa National Cement Factory negotiates with creditors. A substantial majority (84.6 percent) agreed that they indeed negotiate with creditors to the extent of the credit period.

Table-19 Short-term funds of the business for long-term investment

Question	Options	Frequency	Percent %
Do you use short-term funds of the business for long-term investment?	Yes	2	15.4
	No	11	84.6
	Total	13	100.0

Sources, own Survey

According to the above table 84.6% of respondents respond that dire dawa national cement factory does not use short term funds for long term investment and 15.4% respondents the company has such investment. But it reflects that the company use short term fund for short term investment. .

Ratio analysis from financial statement

Liquidity Ratios

Liquidity ratios measure the ability of a firm to meet its immediate obligations and reflect the short – term financial strength or solvency of a firm. In other words, liquidity ratios measure a firm’s ability to pay its current liabilities as they mature by using current assets. There are two commonly used liquidity ratios: the current ratio and the quick ratio.

i) **Current ratio** – measures the ability of a firm to satisfy or cover the claims of short-term creditors by using only current assets. This ratio relates current assets to current liabilities.it calculated as

$$\text{Current ratio} = \frac{\text{current asset}}{\text{current liability}}$$

TABLE 20 Current ratio

Items	2021	2022	2003
Current asset	69,469,409.93	88,984,730.38	150,984,730.38
Current liability	48,078,295.96	52,749,190.58	68,862,170.55
CR	1.44	1.68	2.2

Source: financial statements of the company

Table 20 Show that dire dawa national cement factory has birr 1.44 in 2021, 1.68 in 2022 and 2.2 in 2023 in current asset available for every 1 birr in current liability. Increasing current ratio over time suggest that improved the liquidity of the company by increasing sweep accounts, decreasing overhead cost and monitoring account receivable effectively. Generally dire dawa national cement factory has good ability to meet its obligation.

ii) **Quick ratio (Acid – test ratio)**- measures the short-term liquidity by removing the least liquid current assets such as inventories. Inventories are removed because they are not readily or easily convertible into cash. Thus, the quick ratio measures firm’s ability to pay its current liabilities by using its most liquid assets into cash.

$$\text{Quick ratio} = \frac{\text{current-inventory}}{\text{current liability}}$$

Table 21 Quick ratio

ACCOUNTS	2021	2022	2023
Current asset	69,469,409.93	88,984,730.38	150,984,730.38
Inventory	35,518,429.2	45,201,722.34	88,353,014.1
Current liability	48,078,295.96	52,749,190.58	68,862,170.55
QR	0.7	0.83	0.91

Source: financial statement of the company

As it’s presented in table 21, Dawa national cement factory has 0.7 in 2021, 0.83 in 2022 and 0.91 in 2023 in quick asset available for every 1 birr in current liability. Quick ratio is increased continuously over time by improving collection period and decreasing drawing for non-business activities. So, the company has sufficient liquidity.

Activity Ratios

Activity ratios measure the degree of efficiency a firm displays in using its assets. These ratios include turnover ratios because they show how rapidly assets are being converted (turned over) into sales or cost of goods sold. Activity ratios are also called asset management ratios, or asset utilization ratios, or efficiency ratios. Generally, high turnover ratios are associated with good asset management and low turnover ratios with poor asset management

1) **Average collection period** – This ratio measures the quality of debtors. A short collection period implies prompt payment by debtors. It reduces the chances of bad debts. Similarly, a longer collection period implies too liberal and inefficient credit collection performance. It is difficult to provide a standard collection period of debtors.it calculated as

$$\text{Average collection period} = \frac{\text{receivable}}{\text{cost of goods sold} / 365}$$

Table 22 Average collection period

Item	2021	2022	2023
Account receivable	25,688,025.62	29,130,938.2	65,183,365
Cost of goods sale	176,853,120.4	200,503,467.1	330,830,720.7
ACP	53	67.8	72

Source: financial statement of the company

As it’s present in table 3 dire dawa national cement factory’s average collection period 53 in 2021, 67.8 in 2022 and 72 in 2023.it shows the companies average collection period is increased continuously. Because implies too liberal and inefficient credit collection performance.

Inventory turnover in days (ITID) Is measure the number of days inventory is kept before it is sold to customer.it calculated as

$$ITID = \frac{\text{Inventory}}{\text{cost of goods sold} / 365}$$

Table 23 Inventory turnover in days

Items	2021	2022	2023
Inventory	35,518,429.2	45,201,722.34	88,353,014.1
Cost of goods sold	176,853,120.4	200,503,467.1	330,830,720.7
ITID	73.3	82.28	97.5

Source: financial statement of the company

According to the above table 23 Dire dawa national cement factory’s inventory in average in days sold out is 73.3 in 2021, 82.28 in 2022 and 97.5 in 2023. ITID is increased over time continuously. by poor order management and less quality inventory.

Average Payment Period (APP)

In general, if a company has a small number of accounts payable days, it could mean that the company is paying the bills very early or is taking advantage of purchase discounts (requiring early payment). On the other hand, if a company has a large number of accounts payable days, it could mean that the company has low cash flows not sufficient to pay bills on time. it calculated as

$$\text{Average payment period} = \text{Account payable} / (\text{cost of goods sold} / 365)$$

Table 24 Average Payment Period

Items	2021	2022	2023
Account payable	58,257,118	65,342,128.82	75,699,623.466
Cost of goods sold	176,853,120.4	200,503,467.1	330,830,720.7
APP	120	119	83.5

Source: financial statement of the company

As its presented in table 5 Dire dawa national cement factory average payable period has 120 in 2005, 119 in 2006 and 83.5 in 2007. so it indicates that the companies average payable period is continuously decreased. It means that the company is paying the bills very early or is taking advantage of purchase discounts (requiring early payment).

Cash conversion cycle (CCc)

Cash conversion cycle mean that firm typically follow a cycle in which companies purchase inventory, sell goods on credit, and then collect receivable.

cash conversion cycle is also used to measure the aggressiveness of working capital policy. It is believed that longer cash collection cycle corresponds to defensive working capital and shorter cash collection cycle corresponds to aggressive working capital policy (Arnold, 2008 p. 530-310. In order to calculate the CCC one has to first calculate average collection period, inventory turnover in day and average payment.

$$CCC = \text{Average collection period} + \text{Inventory Turnover in day} - \text{Average Payment Period}$$

Table 6 Cash conversion cycle

Items	2021	2022	2023
Average collection period	53	67.28	72

Inventory turnover in days	73.3	82.28	97.5
Average payable period	120	119	83.5
CCC	6	30	83.5

Source: *financial statement of the company*

As it's presented in table 6 Dire Dawa National Cement Factory has 6 in 2021, 30 in 2022 and 83.5 in 2023 days it takes the companies receive a cash from a customer. The company credit policy was aggressive credit policy in 2021 and 2022. In 2023, the company's cash conversion period is long so it indicates the company policy changes to defensive credit policy.

Conclusion

A review of Dire Dawa National Cement Factory's working capital management procedures reveals a generally strong liquidity position, with the quick ratio rising from 0.7 to 0.91 during the same period and the current ratio improving from 1.44 in 2021 to 2.2 in 2023. However, as seen by the rising average collection period and increasing inventory turnover in days, the organization is experiencing inefficiencies in both credit collection and inventory management. The company's cash conversion cycle increased dramatically from 6 days in 2021 to 83.5 days in 2023, suggesting a change in working capital strategy from one that was more aggressive to one that was more conservative. Its financial stability is also at risk due to the absence of official credit investigation procedures and a reorder level policy.

Recommendations

Stricter credit collection policies should be put in place by Dire Dawa National Cement Factory in order to improve cash flow and working capital management by lowering the average collection period. In order to reduce inventory accumulation and expedite the inventory turnover time, the organization had to implement a proficient inventory management system. Further fortifying the company's financial procedures and lowering operational risks would be the implementation of a re-order level policy and a formal credit investigation process prior to credit issuance. Additionally, optimizing the cash conversion cycle will require striking a balance between conservative and proactive working capital measures.

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