

THE EFFECT OF PROFITABILITY ON WORKING CAPITAL MANAGEMENT AND COMPANY CAPITAL STRUCTURE

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Abstract

The significance lies in comprehending the correlation between profitability, working capital management, and capital structure within the framework of corporate financial decision-making. This study aims to elucidate the influence of profitability on the efficiency of working capital management and the policy regarding capital structure. The employed approach is Systematic Literature Review (SLR), which involves the identification, selection, and evaluation of pertinent scientific literature. The findings indicate that the profitability level has an impact on a company's capacity to handle working capital, affects the cash cycle, and can elucidate decisions regarding capital structure policy. While high profitability enables increased access to external financial resources, low profitability can present difficulties in managing working capital. The discussion encompasses the practical ramifications of these findings, such as implementing astute financial strategies to enhance profitability and optimize the management of working capital. Ultimately, this study offers a comprehensive perspective on the correlation among profitability, working capital management, and capital structure. Acquiring this knowledge is crucial for companies to make informed financial decisions and guarantee long-term viability and steady expansion in a constantly changing business landscape.

Keywords : *Management, Capital, Company, Profitability, and Structure*

1. INTRODUCTION

A company is a commercial entity that seeks to generate profits by engaging in the production, sale, or provision of goods and services. Every company has unique requirements that are influenced by its industry and the size of its operations. Companies typically require competent human resources to oversee diverse functions including production, marketing, finance, and human resources. In addition to that, companies also require financial capital to fund operational activities, investments, and business expansion. Contemporary infrastructure and technology are crucial prerequisites for companies to effectively compete in a continuously expanding market (Yanti & Darmayanti, 2019). Furthermore, it is imperative for companies to comprehend and adapt to customer requirements while adhering to relevant regulations and industry benchmarks. By fulfilling these diverse requirements, corporations can attain their business objectives and contribute to the overall expansion of the economy.

Company profitability is a metric that gauges the efficiency with which a company generates profits through its operational endeavors. The significance of profitability extends beyond mere profit generation, encompassing critical implications for the company's survival and expansion. The company's ability to consistently generate profits demonstrates its operational efficiency and capacity to create additional value for shareholders. Companies with high profitability have the ability to allocate funds towards investment, innovation, and the development of new products or services. This, in turn, can enhance their competitiveness within the market (Yanti & Darmayanti, 2019).

Positive financial gains also aid companies in retaining and attracting investors, who contribute supplementary financial assets to facilitate expansion and strategic initiatives. In addition, a strong level of profitability allows companies to offer competitive salaries, provide employee benefits, and sustain a positive work environment. This not only fosters employee

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satisfaction but also exerts an impact on productivity and innovation. Consistent profitability enhances a company's reputation among suppliers, customers, and potential business partners (Taib, 2019). Hence, a company's profitability serves as both a gauge of its financial well-being and a crucial element in establishing enduring value and constructing a stable basis for sustainable expansion. Companies that possess the ability to effectively control and enhance their profitability are more likely to succeed in attaining their business objectives and adjusting to shifts in the market and economic obstacles. The profitability issues faced by a company can differ and are impacted by various internal and external factors. A primary challenge frequently encountered by companies is the issue of elevated operational expenses. Unregulated expenses related to production, overhead, and distribution can negatively impact a company's profitability. In addition to that, intense market competition and selling prices that do not align with production costs can also pose a significant challenge (Prastika & Candradewi, 2019).

Profitability can be adversely affected by variations in economic conditions, fluctuations in exchange rates, and volatility in raw material prices. Other significant issues can arise from errors in marketing strategies, a dearth of product innovation, or the company's failure to anticipate shifts in market trends. Inadequate financial management, encompassing ineffective debt management or unsuitable pricing strategies, can result in diminished profitability (Prastika & Candradewi, 2019). In addition to internal factors, external factors such as changes in government regulations, alterations in tax policy, or occurrences like natural disasters or global economic crises can pose additional challenges that impact a company's profitability. Hence, in order to address profitability issues, companies must conduct a thorough assessment of multiple facets of their operations, finances, and business strategy. To enhance company profitability, implementing efficient cost-cutting measures, expanding the range of products or services, and adjusting to market dynamics are crucial steps (Taib, 2019).

Studying the correlation between company profitability, working capital management, and company capital structure is highly pertinent as it profoundly affects the company's sustainability and financial well-being. Management decisions regarding working capital can be influenced by profitability, as indicated by net profit and rate of return on investment. More lucrative firms possess superior financial capacities to effectively handle their working capital, including streamlining cash and inventory cycles, as well as prolonging payment terms with suppliers. In addition, the profitability of a company can also significantly influence the determination of its capital structure. Profitable companies often enjoy enhanced access to external funding options, enabling them to effectively utilize debt or equity to fulfill their capital requirements. Conversely, companies that have low levels of profitability may have fewer choices when it comes to financing, and this can impact their decisions regarding how they structure their capital. This research can offer comprehensive understanding of the correlation between profitability, working capital management, and company capital structure. The research findings can offer practical advice for financial managers and other stakeholders in enhancing the management of working capital and selecting a capital structure that aligns with the company's profitability level. Through comprehending these dynamics, companies can make well-informed and strategic financial decisions in order to attain long-term objectives.

2. IMPLEMENTATION METHOD

A Systematic Literature Review (SLR) is a research methodology employed to methodically gather, assess, and integrate scientific literature that is pertinent to a specific research subject or query. The literature selection process in SLR is conducted rigorously, adhering to pre-established research protocols. The process involves identifying relevant literature sources, selecting studies that meet specific inclusion criteria, extracting data from the selected studies, and analyzing the findings (Han & Lin, 2023). The key feature of a Systematic Literature Review is its methodical approach aimed at minimizing bias and ensuring that the research included in the review is the most pertinent and of the utmost quality. Systematic Literature Review (SLR) enables researchers to discern patterns, identify areas of limited knowledge, and establish agreement within

the scientific literature (Zhu et al., 2018). The outcomes of Systematic Literature Review (SLR) can offer a more all-encompassing perspective on the advancement of knowledge in a particular field. These discoveries can serve as a foundation for the formulation of theories or the planning of additional research endeavors. This method is commonly employed across various scientific disciplines, such as computer science, management, medicine, and numerous other fields, to systematically develop a comprehensive comprehension of a research subject.

3. RESULTS AND DISCUSSION

Based on the SLR results of 7 journals that match the keywords searched, namely management, capital, company, profitability, and structure, the following results were obtained:

No.	Article Title	Writer	Research Findings/Results
1	The Influence of Profitability, Company Size, Capital Structure, and Liquidity on the Value of Food and Beverage Companies	(Yanti & Darmayanti, 2019)	Capital structure and liquidity levels have a positive impact on company valuations in the food and beverage sector on the Indonesia Stock Exchange in the 2014-2017 period.
2	The Influence of Profitability, Asset Structure, and Liquidity on the Capital Structure of Building Construction Subsector Companies on the IDX	(Prastika & Candradewi, 2019)	Profitability has a negative impact on a company's capital structure, which means that an increase in profitability will cause a decrease in the company's capital structure. Conversely, if profitability decreases, the capital structure of companies in the building construction subsector on the Indonesia Stock Exchange (BEI) will experience an increase.
3	Analysis of the Influence of Profitability, Sales Growth, Company Size, and Company Age on the Capital Structure of Brass Craft Micro, Small and Medium Enterprises in Pati Regency	(Cahyo Nugroho, 2019)	From the research results, it can be concluded that profitability has a significant positive impact on capital structure, sales growth also has a significant positive impact on capital structure. Meanwhile, company size shows a significant negative impact on capital structure, and company age has a significant positive impact on capital structure.
4	The Influence of Working Capital Turnover Level, Capital Structure and Company Scale on Profitability	(Azlina, 2019)	From the research findings, it is concluded that together, the level of working capital turnover, capital structure, and company scale have a significant impact on the profitability of companies in the Property and Real Estate sector on the Indonesia Stock Exchange (BEI). However, if viewed partially, only the level of working capital turnover and capital structure influence profitability, while company scale does not have a significant impact.
5	The Influence of Capital Structure, Working Capital	(Agusentoso, 2019)	Findings from the research show that any increase in a company's capital structure, as measured by the debt-to-equity ratio, can

THE EFFECT OF PROFITABILITY ON WORKING CAPITAL MANAGEMENT AND COMPANY CAPITAL STRUCTURE

Elwisam, Melati, Rahayu Lestari, Kumba Digidowiseiso, Rosyidah Muhammad

	Turnover, and Company Size on Company Value		increase the company's valuation. This company's capital structure includes long-term financing sources, such as debt, preferred shares, and capital invested by shareholders.
6	The Influence of Profitability, Asset Structure, and Sales Growth on Share Prices with Capital Structure as an Intervening Variable in Manufacturing Companies on the Indonesian Stock Exchange	(Kartika, 2019)	From the research results it can be concluded that: (1) There is no positive influence between profitability and capital structure, (2) There is no negative influence between asset structure and capital structure, and (3) There is a positive influence between sales growth and capital structure.
7	The Influence of Profitability, Growth Opportunity, Capital Structure on Company Value in Public Companies in Indonesia	(Hermuningsih, 2023)	The variables profitability, growth opportunities and capital structure have a positive and significant impact on company valuation. This means that increased profitability, higher growth opportunities, and a larger proportion of debt in the company's financial structure together contribute to an increase in company value.

Profitability is a crucial metric that characterizes a company's capacity to generate profits from its operational endeavors. This concept encompasses several financial ratios that serve as indicators of the company's efficiency and financial performance, including net profit, gross profit, and return on investment. The degree of profitability holds significant importance as it has a direct impact on the long-term viability and expansion of the company (Mahapsari, 2020). The company's high profitability is indicative of its effective resource and operational management, resulting in increased profits from its revenue. This demonstrates a favorable indication to shareholders, investors, and relevant parties that the company possesses robust fundamentals and is capable of delivering additional value. Achieving high profitability enables a company to effectively reduce its debt, distribute dividends to shareholders, and allocate funds towards future growth opportunities (Setiawan et al., 2021).

On the other hand, a lack of profitability can suggest issues with operational management, unsuitable pricing strategies, or intense competition. Companies should assess their business strategy, identify areas where costs can be optimized, and seek opportunities to enhance efficiency. In addition, the company's image in the market and industry can also be influenced by the level of profitability. Business partners, suppliers, and customers typically place greater value and trust in companies that demonstrate a high level of profitability. Profitability is a key metric used to assess a company's financial well-being in the field of financial analysis (Denziana & Yunggo, 2019). Hence, comprehending and effectively controlling profitability is crucial for attaining a company's enduring objectives and sustaining competitiveness in a dynamic market.

The impact of company profitability on working capital management is a vital component of a company's financial strategy. The profitability of a company, as indicated by its net profit and return on investment, directly affects its capacity to effectively manage working capital. Companies that yield substantial profits typically possess robust financial resources to sustain day-to-day operations, encompassing supplier payments, inventory control, and customer billing (Wardhani et al., 2021). Strong profitability can mitigate the risk of liquidity shortages and provide a competitive

advantage in negotiations with suppliers and customers. Moreover, companies that are enjoying higher profitability may have the capacity to augment their inventory or offer more favorable payment conditions, thereby enhancing the efficiency of the working capital cycle. Conversely, companies that have low levels of profitability may encounter difficulties in effectively managing their working capital (Fajrida & Marlina, 2020). Insufficient financial resources can impede a company's capacity to fulfill its financial obligations or acquire essential resources. This could lead to heightened liquidity risk and exert additional strain on day-to-day operations.

Companies can develop more efficient financial strategies by comprehending the correlation between profitability and working capital management. Enhancing operational efficiency or introducing product innovation can aid in the optimization of working capital management, thereby boosting profitability. On the other hand, implementing effective strategies for managing working capital can enhance profitability by optimizing the utilization of a company's financial resources (Wardhani et al., 2021). Therefore, achieving financial stability and sustainable growth relies on maintaining a favorable equilibrium between profitability and working capital management. The impact of company profitability on capital structure is a crucial determinant in shaping the financial strategy of a business entity. The selection of capital structure is directly influenced by profitability, which indicates a company's capacity to generate profits from its operational activities. Profitable companies possess greater financial flexibility and are better positioned to secure external capital, such as debt or equity, due to their elevated levels of profitability (Amro, 2020).

Typically, companies that are highly profitable have more freedom to decide whether to use debt capital or equity capital. As profitability rises, companies may be more inclined to utilize funding sources that necessitate fixed interest payments, such as long-term debt. Conversely, when a company's profitability is low, it is likely to exercise caution in utilizing debt and instead rely more heavily on equity capital or internal funding (Novwedayaningayu & Hirawati, 2020). The correlation between profitability and capital structure can also impact the assessment of risk by creditors and investors. Companies that exhibit high profitability are generally regarded as more dependable in fulfilling their financial commitments, thus reducing debt expenses and enhancing their appeal to investors. Conversely, companies that have low profitability may be perceived as more risky, leading to increased expenses for borrowing or challenges in obtaining funding from financial markets (Denziana & Yunggo, 2019).

Through comprehending the impact of profitability on capital structure, companies can formulate financial strategies that align with their specific level of profitability. This decision necessitates meticulous evaluation of risk, cost of capital, and potential long-term returns. Hence, prudent financial management necessitates careful consideration of the intricate correlation between profitability and capital structure in order to attain the optimal utilization of financial resources and ensure long-term growth. The profitability of a company has a substantial influence on the management of working capital and the structure of its capital. An elevated level of profitability can provide a company with a competitive edge in effectively managing its working capital. Profitable companies possess greater financial resources that can be allocated towards meeting daily operational requirements, settling liabilities, and managing inventory (Kartika, 2019).

The favorable influence on the management of working capital can lead to an improved cash cycle, heightened liquidity, and diminished likelihood of cash deficits. Conversely, companies that have a low level of profitability may encounter difficulties in managing their working capital, including the risk of insufficient liquidity and the challenge of meeting their financial obligations promptly. In addition, the company's capital structure is also influenced by the level of profitability. Profitable companies have greater ease in obtaining external financing, such as long-term debt or equity, to support their growth or investment initiatives. Conversely, companies that have low profitability may depend on equity capital or internal financing, or encounter challenges in acquiring external sources of funding (Cahyo Nugroho, 2019).

Companies have the ability to enhance their financial decision-making by adopting more effective and well-thought-out strategies. Implementing strategies to enhance profitability, such as

THE EFFECT OF PROFITABILITY ON WORKING CAPITAL MANAGEMENT AND COMPANY CAPITAL STRUCTURE

Elwisam, Melati, Rahayu Lestari, Kumba Digidowiseiso, Rosyidah Muhammad

optimizing operational efficiency or introducing innovative products, can facilitate more effective management of working capital and offer increased financial adaptability. Furthermore, companies have the ability to create ideal capital structures based on their profitability level in order to attain their long-term financial objectives. Hence, the financial stability, growth, and competitiveness of a company heavily rely on its profitability (Azlina, 2019).

4. CONCLUSION

Through a comprehensive analysis of literature on the impact of company profitability on working capital management and company capital structure, it is evident that profitability significantly influences the financial decisions made by a business entity. Companies with a high level of profitability are able to effectively manage their working capital, optimize cash cycles, and minimize liquidity risks. Furthermore, strong profitability provides companies with a competitive edge in obtaining external funding to facilitate expansion and investment initiatives. Nevertheless, insufficient profitability can present obstacles in the management of working capital, including the risk of insufficient liquidity and the challenge of meeting obligations punctually. Within the framework of capital structure, a company's choice between debt capital and equity capital is influenced by the degree of profitability. Profitable companies are inclined to utilize long-term debt for expansion, whereas less profitable companies may depend more on equity capital or internal funding. Hence, a comprehensive comprehension of the correlation among profitability, working capital management, and a company's capital structure is crucial for companies to make astute financial decisions, enhance financial performance, and attain their long-term objectives.

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