Evaluating Factors of Profitability for Improvement at Padumacom Karya Jaya

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Abstract

The study examined the effect of working capital management on the profitability of PT. Padumacom Karya Jaya as the company has a problem with its decreasing profit, whereas the company has increasing revenue. This study analyzes the debt ratio, average collection period, average payment period, and current ratio as the independent variables and return on assets as the dependent variable. The data was obtained from the monthly financial report of the company for three years. Classical assumption, descriptive statistics, correlation, and multiple regression analysis are used as the methods to analyze the data used for this study. The findings of this study show that there is significant influence of debt ratio, average collection period, and average payment period on the return on assets, whereas there is no significant influence of current ratio on the return on assets. The three variables have negative impact that can be seen through the regression coefficients of 0.003, 0.042, and 0.0155, respectively. Every increase in each variable will decrease profitability and vice versa. The most significance variable is the average payment period, so the company must be concerned about the period to pay its debt, because when the company is late, the creditor will charge interest to the company and also the company might face the currency inflation when it times to pay the debt because company uses other currency to do the transactions.

Keywords
Average collection period, Average payment period, Debt ratio, Current ratio, and Return on assets.

1. Introduction
In the development of globalization and the world's economy, every company always works hard to always be in the competition with other companies. Therefore, no company wants to lose the battle or competition or even worse to fail in performing the business. In this era, every business will always develop as the environment is changing due to the effect of globalization. With the continuous change, it is easy for a new business or company to enter the market and compete with the existing companies. Those newcomer makes the competition more difficult and fiercely. In this case, the existing company must always be ready to defend and compete against other existing companies or the new companies in the future. Thus, in order to always last in the competition, each company is required to always be innovative in facing the changes and competition in the market. Being innovative is not enough, each company is

required to be efficient and effective during the business process to increase the performance of the company to win the competition.

Based on the research done by Shubita and Alsawalhah (2012), a capital structure is a mix of the debt and equity used by the company in its operation. In other words, working capital basically is short-term resources available to the company for financing its day-to-day activity (Rezaei and Pourali 2015; Korankye and Adarquah 2013). The main components of working capital management consist of account receivables, inventory, and account payables in days. Therefore, in order to maintain the productivity of the company, each company needs to have a well-managed working capital. According to EL-Maude and Shuaib (2016), working capital also known as circulating capital or revolving capital is that organizational capital which is used to invest in the current assets as well as settlement of current liabilities. Based on the research done by EL-Maude and Shuaib (2016), a healthier working capital explains that the corporation is in a sound financial condition capable of subduing its short-term obligations. Therefore, a negative working capital will show that the liquid assets of the corporation are not sufficient to fulfill its current monetary commitment. In other words, the company needs to manage its working capital very well in terms of liquidity to perform well in the market and support the growth of the company for the sake of shareholders. Meanwhile, working capital management refers to all management decisions and actions that ordinarily influence the size and effectiveness of the working capital (Rezaei and Pourali 2015).

PT. Padumacom Karya Jaya is a national company that has been serving the Indonesian companies and organizations for more than 18 years. The main service of the company is as consultant of digital radio telecommunication system. Since the era of the analog radio system, the company has been supported with the certified technicians as the best from Indonesia and has been acknowleged and authorized by Motorola as one of the best company in this industry. PT. Padumacom Karya Jaya has been developing and adding new values to the business. Now, PT. Padumacom Karya Jaya has been changing into a company that provides services on building network such as, Wireless Local Area Network, PABX system, CCTV system or Wirelless Clossed Circuit Television, internet network, and assembling the application into the integrated telecommunication network. During the past few years, the company is facing a problem with the profitability, as shown in the graph below:

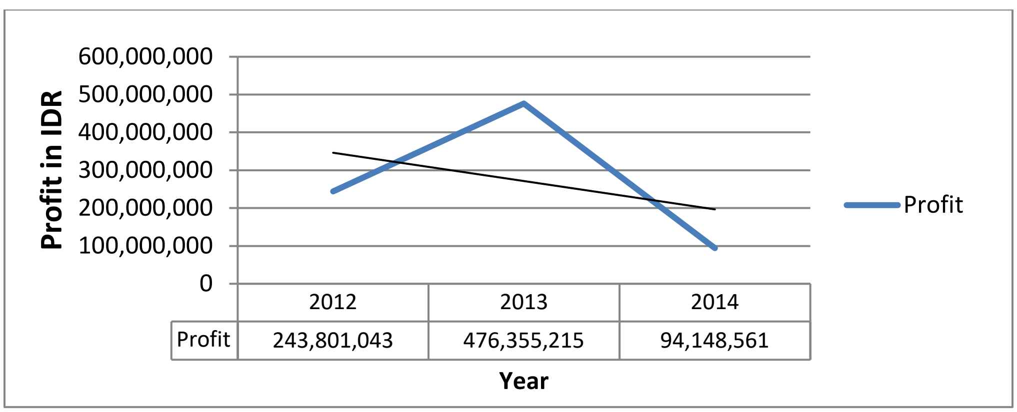

Figure 1. Profit of PT. Padumacom Karya Jaya

This condition should not have happened because with the increasing revenue compared to the previous year, the company should have an increased profit that will lead to the increasing of return on assets. In contrary of the increasing revenue, the company was facing an issue with the decreased profitability and return on assets. By having this issue, the company will face difficulties in achieving its vision and missions, which giving the best benefit for the stockholders and employees.

1.1 Objectives

In prior of this research, the author discussed the possible cause of this issue with the directors and managers of the company. The objectives of this research to suggest how to further improve business performance by first finding Debt Ratio, Average Collection Period, Average Payment Period, Current Ratio effect on profitability.

2. Literature Review

Profitability

Every company and organization in this world is always seeking for a profit to keep growing and competing with other companis in the market. With the proper management and skill, a company can maintain or manage its resources to make profit and make the company grow. Every company will try to make profit as big as possible from its resources. Managers need to know how to manage all the resources of the company in the most effective and efficient way. According to Lartey et al.(2013) on their research about banks in Ghana, profitability of banks refers to the ability of a bank to make revenue in excess of any costs that related to the bank's capital base. Therefore, profitability is related to the ability of the company to make revenue or profit based on the capital base of the company for the welfare of any individual or group within the company. According to Gitman and Zutter (2013), profitability refers to the relationship between revenues and costs generated by using the firm's assets in productive activities. According to Weygandt et al. (2011), profitability ratios measure the income or operating success of a company for a given period of time. When the company is lacking of income, it can lose its ability to obtain debt and equity financing. The ratios of probability are gross profit margin, operating profit margin, return on equity, return on assets, earning per share, net profit margin.

Return on Assets

Return on Assets can show how effective a management is in applying the available resources for profit education (Rezaei and Pourali 2015). According to Weygandt et al. (2011), return on assets refers to a measurement of overall profitability of assets. According to Ross et al. (2016), return on assets is a measure of profit per dollar of assets. Return on Assets as dependent variable had been used in the previous research done by Saleem and Rehman (2011); Pais and Gama (2015), and Lartey et al. (2013). This ratio can be calculated by using this formula:

$$Return\ on\ Assets = \frac{Net\ Income}{Total\ Assets}$$

Working Capital Management

Working capital management can directly affect the liquidity and profitability of a company, so it is an important financial and organizational management component (Rezaei and Pourali 2015; Raheman and Nasr 2007). Working capital management is defined as the administration of current assets in the name of cash, marketable securities, receivables and staff advances, and inventories (EL-Maude and Shuaib 2016; Van Horne 1995). According to EL-Maude and Shuaib (2016), a working capital is known as circulating capital or revolving capital is that organizational capital which is used to invest in the current assets as well as settlement of current liabilities. Whether a company is in a good or bad condition can be seen through the working capital management. If the company is capable in subduing its short-term obligations, it means that the company has a healthy and good working capital management. It was said that a well-managed working capital can promote a company's well being in the market in terms of liquidity and it also acts in favor for the growth of shareholders' value (EL-Maude and Shauib 2016; Jeng-Ren et al. 2006). According to Libby et al. (2004), working capital is defined as the dollar difference between current assets and current liabilities and working capital is important to both manager and financial analyst because it has a significant impact on the health and profitability of a company.

According to Ross et al. (2016), the term working capital refers to a firm's short-term assets, such as inventory and the credit given to its customers, and its short-term liabilities, such as money owed to the suppliers. They explained that managing the firm's working capital is a day-to-day activity that ensures that the firm has sufficient resources to continue its operations and avoid costly interruptions (Ross et al. 2016). According to Gitman and Zutter (2013), working capital management refers to the management of current assets and current liabilities. Working capital is current assets, which represent the portion of investment that circulates from one form to another in the ordinary conduct of business (Gitman and Zutter 2013). According to Mathur and Rangarajan (2007), working capital management is also known as short-term financial management, largely deals with the management and control of current assets and current liabilities. According to Block et al. (2009), working capital management involves the financing and management of the current assets of the firm. In other words, working capital management involves the process during financing and controlling the current assets of the company.

Gitman and Zutter (2013) explained the importance of efficient working capital management is indisputable given that a firm's viability relies on the financial manager's ability to effectively manage receivables, inventory, and payables. According to Libby et al. (1998), management of working capital is an important activity that can have a dramatic impact on a company's profitability. Working capital management is very important because it can be used by managers as an indicator of company's ability to pay its liabilities. An efficient working capital management is associated with lots of advantages amongst which include but not limited to speedy payment of short term commitments on firms (EL-Maude & Shuaib, 2016). According to EL-Maude and Shuaib (2016), on the other hand, inefficient working capital management leads to abysmal failures of many corporate organizations.

Leverage

According to Gitman and Zutter (2013), financial leverage refers to the magnification of risk and return through the use of fixed-cost financing, such as debt and preferred stock. According to Ross et al. (2016), leverage ratios are also known as financial leverage ratios and long-term solvency ratios, which are intended to address the firm's long-term ability to meet its obligations, or, more generally, its financial leverage. Leach and Melicher (2012) explains that leverage ratios indicate the extent to which the venture has used debt and its ability to meet debt obligations. According to Brealey and Myers (2003), the leverage ratios show how heavily the company is in debt. The ratios used to define this ratio are debt ratio, time interest earned, average collection period, average payment period.

Debt Ratio

According to Gitman and Zutter (2013), debt ratio refers to the measures the proportion of total assets financed by the firm's creditors. Debt ratio as an independent variable had been used in the previous research done by Shubita and Alsawalhah (2012) and in the study, it is stated that there is significantly negative relation between debt and profitability.

Average Collection Period

Average collection period is also known as the average age of account receivables. This measurement can help the managers to do an evaluation of company's credit and collection policies. According to Gitman and Zutter (2013), average collection period is the average amount of time needed to collect account receivable. According to the Weygandt et al. (2010), account receivables turnover refers to the number of times, on average the company collects receivables during the period and the popular way to measure this ratio is by converting it into days, which called as the average collection period. They mentioned that the general rule of this ratio is that the collection period should not greatly exceed the credit term period (Weygandt et al 2011). According to Ross et al. (2016), account receivable period refers to the time between sale of inventory and collection of receivable. According to the research done by Rezaei and Pourali (2015), the result shows that there is a significant relationship between accunts receivable period and profitability, and as the result, if the accounts receivable period reduced, the firm profitability will be increased.

Average Payment Period

According to Gitman and Zutter (2013), average payment period refers to the average amount of time needed to pay accounts payable. According to Ross et al. (2016), accounts payable period refers to the time between receipt of inventory and payment for it. According to Rezaei and Pourali on their research (2015), the result of the analysis shows that there is a significant relationship between accounts payable period and profitability, and if the accounts payable period reduced, then the firm profitability will be increased.

Liquidity Ratio

According to Weygandt et al. (2011), liquidity ratio refers to measurement of the short-term ability of the company to pay in maturing obligations and to meet unexpected needs for cash. Based on Gitman and Zutter (2013), the liquidity of a firm is measured by its ability to satisfy its short-term obligations as they come due. According to Ross, Westerfield et al. (2016), the primary concern of this is the firm's ability to pay its bills over the short run without undue stress, short-term solvency ratios as a group are intended to provide information about a firm's liquidity, and sometimes known as the liquidity measures. According to the research done by Lartey et al. (2013), the research shows that even the listed banks were increasing their absolute profit within the period, their profit was actually declining withtin the same period of time, and the result of the research shows that there is a weak positive relationship between the liquidity and the profitability of the listed bank in Ghana. The ratio we can use to measure the ability of the company are current ratio and quick or acid-test ratio.

Current Ratio

According to Gitman and Zutter (2013), current ratio refers to the measurement of the firm's ability to meet its short-term obligations. Weygandt, Kimmel and Kieso explained that this ratio is a widely used measure for evaluating a company's liquidity and short-term debt paying-ability. Sometimes, current ratio refers to the working capital ratio, which is working capital that can be calculated by current assets minus current liabilities. Even though, these two are refered to the same ratio, the current ratio is more dependable indicator of liquidity than working capital (Weygandt et al. 2011). To a creditor such as supplier, the higher the current ratio, the better, and to the firm itself, a high current ratio indicates liquidity, but it also may indicate an inefficient use of cash and other short-term assets (Ross et al 2016).

"Empirical Examination of the Association of Working Capital Management and Firm's Profitability of the Listed Food and Beverages Firms in Ghana", done by EL-Maude and Shuaib in 2016, concluded that there is a positive and negative effect of working capital management on the profitability of the Food and Beverages companies in Nigeria. This research used one dependent variable, which is profitability measured using gross operating profit ratio. The researchers used four independent variables, which are cash conversion cycle, average collection period, average payment period, and average inventory period. Based on the research, it was found that the inventory turnover and account receivable have significant positive effect on the profitability, whereas the cash conversion cycle and account payable have a significant effect on the profitability.

"The Relationship between Capital Structure and Profitability", done by Shubita and Alsawalhah in 2012, stated that the capital structure decision is crucial for any business organization. The researchers used one dependent variable, which is profitability measured using return on assets. The independent variables are short-term debt to total assets ratio, long-term debt to total assets ratio, and total debt to total assets ratio. The findings of this research show that there is a significantly negative relationship betweem each independent variable and profitability as the dependent variable.

"Working Capital Management and SMEs Profitability: Portuguese Evidence", done by Pais and Gama in 2015. This research concluded that from the analysis indicates that a practice of more aggressive working capital management policies increase firms profitability. The research used one dependent variable, profitability measured using the return on assets. The four independent variables are number of days account receivable, number of days account payable, number of days inventory, and the cash conversion cycle. The finding of this research shows that there is a negative relationship between the inventory turnover, account payable, account receivable, cash conversion cycle and proftitability.

"The Relationship between Working Capital Management Components and Profitability: Evidence from Iran", done by Rezaei and Pourali in 2015, used one dependent variable, which is profitability measured using return on equity and used four independent variables, which are inventory holding period, average collection period, average payment period, and cash conversion cycle. The research concluded that working capital management should be considered in order to create valur for shareholders and recommended to focus separately on each component of working capital role on the company. The findings show that there is a negative relationship between inventory turnover periods, receivables collection period, accounts payable period and cash conversion cycle with profitability.

"Impacts of Liquidity Ratios on Profitability", done by Saleem and Rehman in 2011. This research used three dependent variables which are return on assets, return on equity, and return on investment. The three independent variables are current ratio, quick ratio, and liquid ratio. The findings show that the return on assets is significantly affected by only liquid ratio. The current ratio and quick ratio is not significantly affect the profitability or return on assets. Therefore, based on the prior studies, the theoretical model is shown in Figure 1.

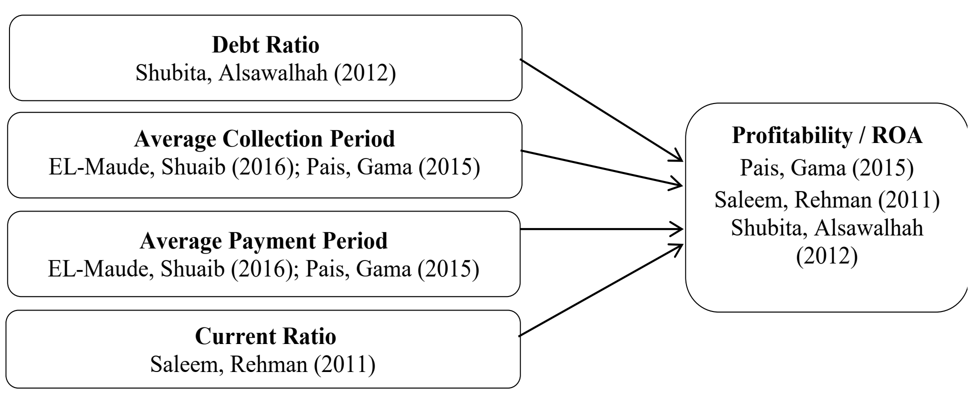

Figure 1. Theoretical Model

3. Methods

The type of this research is associative, quantitative research. There are four independent variables, which are debt ratio, average collection period, average payment period, and current ratio. The dependent variable is return on assets as a measure of the profitability. The variable was analyzed using the multiple regression method to examine the influence of independent variable. The software used for research is PASW, which is same with the SPSS 20.0. The other test was run as the requirement for a good regression model, which are normality, multicollinearity, heteroscedasticity, autocorrelation.

4. Data Collection

The data was collected through the monthly financial report of the company from the year 2012-2014 which converted into the ratio used for this research. The time horizon is time series in which the data collected was from a series period of time.

5. Results and Discussion

After conducting the classic assumption test, the data was processed using the multiple regression to obtain the result shown below Table 1.

Table 1. Result of Regression Analysis

Beginning Hypotheses	**Sig ≥ 0.05**	**Regression Coefficient**	**Result**
Ha1: There is significant influence of debt ratio on return on assets.	0.001 < 0.05	-0.003	Accepted
Ha2: There is significant influence of average collection period on return on assets.	0.045 < 0.05	-0.042	Accepted
Ha3: There is significant influence of average payment period on return on assets.	0.000 < 0.05	-0.155	Accepted
Ha4: There is significant influence of current ratio on return on assets	0.061 > 0.05	2.192	Rejected

From the result of this test, it indicates that the first independent variable (debt ratio) has the coefficient value of -0.003, t-statistics of -0.024, and the t-significance of 0.001. This result indicates that the t-significance is smaller than the 0.05 (0.001 < 0.05). Therefore, it can be concluded that the there is a significant influence of debt ratio on profitability. The result for the second independent variable (average collection period) indicates that the coefficient value is -0.042, t-statistics is -1.648, and the t-significance is 0.045. This result indicates that the t-significance 0.045 is bigger than 0.05 (0.045 < 0.05). Therefore, the there is a significant influence of average collection period on profitability.

Based on the result of the third independent variable (average payment period), it indicates that the coefficient value is -0.155, the t-statistics is -6.819, and the t-significance is 0.000. It means that the t-significance is smaller than the 0.05 (0.000 < 0.05). Therefore, it indicates that the independent variable (average payment period) is significantly influencing the dependent variable (return on assets). From the result, it indicates that the independent variable (current ratio) has the coefficient value of 2.192, the t-statistics of 1.947, and t-significance of 0.061. This result indicates that the t-significance is bigger than 0.05 (0.061 > 0.05). Therefore, it means that the last independent variable (current ratio) is not significantly influencing the dependent variable (return on assets).

The result of the test indicates:

- If each independent variable (DR, ACP, APP, and CR) is 0, then the dependent variable (ROA) is 12.410%.
- The regression coefficient of -0.003 (DR) implies that an increase in debt position is associated with a decrease in profitability. Therefore, it indicates that every additional 1% will decrease the Return on Assets as much as 0.003%.

- The regression coefficient of -0.042 (ACP) implies the opposite relationship betweem accounts receivable period and profitability. Therefore, if the accounts recervable period reduces, profitability will be increased as much as 0.042%.
- The regression coefficient of -0.155 (APP) implies the opposite relationship between accounts payable period and profitability. Therefore, if the accounts payable period reduced, profitability will be increased as much as 0.155%.
- The regression coefficient of 2.192 (CR) implies when every additional 1% can result to an increase in profitability. Therefore, it indicates that every additional 1% will increase Return on Assets as much as 0.2192%.

6. Conclusion

Based on the result of the test, it can be concluded that:

1. There is significant influence of debt ratio on profitability of PT. Padumacom Karya Jaya.
2. There is significant influence of average collection period on profitability of PT. Padumacom Karya Jaya.
3. There is significant influence of average payment period on profitability of PT. Padumacom Karya Jaya.
4. There is no significant influence of current ratio on profitabiliy of PT. Padumacom Karya Jaya.

It is proven that debt ratio, average collection period and account payable period have significant negative effect on profitability with regression coefficients of 0.003, 0.042, and 0.0155, respectively. Every increase in each variable will decrease profitability and vice versa. Therefore, to improve further profitability the company must be concerned about the period to pay its debt. Because if the company is late, the company will be charged the interest from its creditor and the currency inflation can decrease the profitability of the company. In conclusion, it is important for the company to minimize its debt, use other current assets when purchasing the equipment, obtain more capital or assets so the company can purchase in cash, and has to be wiser in collecting its account receivable. As a result, working capital has to be managed in order to increase the profitability and create more value for the shareholders and employees. It is also recommended that the company has to separately focus on each component of the working capital on the company. This study is limited to the three years period of time, therefore other researcher can use a longer period and this study is limited to four independent variables, therefore other researcher can use other or more variables.

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