



THE IMPACT OF PROFITABILITY AS A MEDIATOR IN THE RELATIONSHIP BETWEEN WORKING CAPITAL MANAGEMENT AND STOCK RETURN

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Abstract. This research paper aims to examine the impact of working capital management on stock returns, considering profitability as a mediating variable, in order to provide financial managers and stock market stakeholders with clear insights for better decision-making. These concepts are fundamental to financial institutions particularly Malaysian companies, which rely heavily on effective financial management to achieve their strategic objectives. The study employed a quantitative approach, analyzing a sample of companies listed on Bursa Malaysia over the period from 2014 to 2024. The analysis focused on the relationships between profitability (mediating variable), working capital management (independent variable), and stock returns (dependent variable). Working capital management was assessed through three dimensions: liquidity management, inventory management, and short-term debt management. Statistical analysis was conducted using SPSS and Smart PLS software. The results indicate that liquidity management has a positive impact on both profitability and stock returns. Conversely, inventory management and short-term debt management showed a negative relationship with both profitability and stock returns. A positive relationship was observed between profitability and stock returns. Furthermore, profitability was found to partially mediate the relationship between the dimensions of working capital management and stock returns. Based on these findings, it is evident that management needs to adopt sound working capital management strategies to achieve desired objectives. The originality of this study lies in the mediating role played in establishing a clear impact between capital management and stock returns.

Keywords: Capital management, liquidity management, inventory management, short-term debt management, profitability, stock return.

Introduction

There are plenty of financial and accounting information that need evaluating to be comprehensible and easy for the analysts who gather the data. In which, different financial ratios are utilized for the ease of measuring the firms financial health. These ratios are one of the most important methods that are used for assessing the performance of the company, and being able to tell if the company is declining or improving. The interests of creditors, managers, and shareholders as well as other persons who are interested in financial ratios in significantly different amounts. Financial ratios are used to find benchmarks, where they would be compared with different firms and their counterparts, financial data ratios were used as to understand the trend of these firms, it's also used to know the expectation ratios to be able to test the financial statements of firms more precisely.

Financial ratios would give you the chance to reach Aspects of financing which show, liquidity, profitability, and other financing aspects. The interpretation processes have great use and importance to reach both the strengths and problems which are represented by weaknesses in the businesses and activities carried out by firms. The use of general financial ratio is mostly considered as one of the means that can be used to evaluate the firm's performance. This study is used to focus on the link between (profitability and Working Capital Management) as explanatory variables with stock returns. Most of these studies focus on linking loans, liquidity, and profit with stocks like (suadnyana et al., 2026;sundberg and ftaieh, 2025; ferranti and handoyo, 2025; hocky et al., 2025).

Furthermore, the relationship between the dependent and independent variables were demonstrated by a set of ratios. Where this research was performed on a group of industrial firms listed on the stock exchange of Istanbul from year 2015-2025. Some questions would be answered as followed: Does profitability mediate the relationship between working capital management and stock return? The following research paper is organized in the following matter: is an overall review about the relationship between the Working Capital Management and profitability on all stock returns, which is the method used to develop the following studies hypotheses and problems, such as data collection and methods used in the different analysis of processes, the results of this study are discussed along with its conclusions.

Literature Review

" losses result from stock Returns (capital loss) or profit (capital gains) which are gathered from stocks or investments which are traded in certain timeline (syafarudin, 2019)." " Investors are motivated by stock returns to invest and is also counted as a reward for their courage to bear the risks of their investments (sivaprasad & Muradoglu, 2008)." a large amounts of studies focus on stock returns with numerous variables, such as the study of setiawan and judith (2025), which mainly focused on the future stock returns, as well as the study by surtitle and ismayanti (2025), which analyzed market fluctuations and its impact on all stock returns. The study by sihotang et al. (2024) looked into the link between liquidity, stock returns and stock prices. The results of those studies showed that there are significant links between these variables. From most firm's viewpoint, a reaction of investors to the firms performance would lead to a return of shares. Financial ratio analyzes are used to show the state of the firm, whether it was bad or good. The use of executing financial ratio analyzes are to help firms know weaknesses and strengths in the financial aspects, as well as examine the performance of the firm to help them reach their goals that were previously known (syafarudin & julianto, 2019).

Using other people's money is called financial leverage. It's well known that dept is used in companies capital structure. Lots of studies put their focus on the returns on different financial leverages with lots of variables, such as saleh's (2024) study, which showed the impact of financial leverage on financial performance. Arif's (2026) are focused on the link between financial leverage and profitability. While Listy's (2026) study examined the Indonesian market to identify the link and impact of fiscal leverage on company size and liquidity. The study results are indicated to a clear impact among factors studied. The capital structure must be regarded while making a decision about firm funding because it affects the debt mixture. (Al-slehat, 2020). The main objective of these finances is to achieve profits; this gives a meaning to obtaining money from others with the aim of funding the firm's activities and business to gather profits for managers and shareholders, in which increases the value of returns for the owners. This return can be illustrated in different ways that cost more of the financed process or less or equal than the financed value. This would be the best way to raise the percentage of returns on holders (shamsi & salman,

Ahmad, 2015). That'll give you a moderate leverage at the rate of gathering returns from obtaining money from people which is like the value of dept financing costs, and this wont help the shareholders to achieve additional returns from dept financing operations (shamsi, Ahmad, Salman, 2015). Overall financial leverage is used for gathering the results which are used to explain the assets that belong to the company and what these ratios are funding. Also, to tell whether the other fundings that gather from external creditors and actors. In the TTD, it has both the LTD and STD, this is to show the size of debt in the companies (Ebaid, 2009). While Short-term leverage is used to tell the debt-to-total-assets ratios. STD gives of a meaning that the firm's debt, like taxes and accounts payable, which has to be paid within one year. This kind of dept isn't suitable for massive-scale investments. (Ebaid, 2009). In which, the Long-term leverage would be a form of dept used for larger investments with a maturity for decades. LTD is gathered from bonds and banks, and could be used to assess a firm's funding leverage. (Myers, Brealey and Allen, 2017).

Profit is defined as the amount of revenues remaining from the costs of production. Which defines " is the ability to earn profits from a business (Raj and Khan, 2020)". In which the concepts or profits are considered significant in the course of action of understanding those movements of the capitalist systems, as these profits influence entrepreneurs to start the procedure of constructive activities. Profitability would be a great indicator to a firm's failure or success. Evaluating profitability in the future, past, and present is one of the key elements to take notes of (nimalathan & nishanthini, 2013). Even though the return of resources is call the return of investment, and this ratio would likely be the earnings which are used in the process of measuring firm's activities in gathering profits. These processes are finished by using assets in many ways, in which would be the ratio in between the net profit after paying taxes om the total assets (Hussain and Mubeen, 2014). The third ratio would be viewed as the percentage of sales before removing income taxes as well as to interest expenses. In most cases, you could evaluate the strength of firms by being able to operate profit margins (Hamzah, Aswan and idrayana:2020).

The fourth ratio would be the representation of percentage that would relate to the net income in links to the shareholders equity. In which it is also the returns obtained as the results of the investments of investors in their shares in the businesses. (Du Toit and De Wet, 2007). In which the fifth ratio would be the ratio in between of the company's gross profits and the companies sales at the same time.these prices would affect the GPM and this influence on this would be significant. In which when the goods prices raise, the profit margin becomes less(kiradoo, 2019). Some studies would show the link in between return on equity and short-term loans, such as the studies of setena and pasupati (2025), which gave and idea about the effects among Indonesian banks. Which would suggested that this link may only exist among the variables used in the following study. The other studies also link equity and profitability in different ways, such as those by farina and sunarmi(2025);pasaribu et al. (2025), and salsabil(2025).

As said before, Working Capital Management profitability clearly influence the stock returns, negatively and positively. In which, previous studies haven't addressed the mediating effects of profitability in between stock returns and leverage. However, Analyzing these linkages in a market like Malaysia is crucial for understanding the significant impact of these important factors and the nature of their interconnections.

Developing Hypotheses

The Impact of Working Capital Management on Profitability

The relationship between inventory turnover profitability.

Inventory turnover, when measured in days, can indicate the average time companies require to produce finished goods. This metric is calculated using the formula: Cost of Goods Sold /

Average Inventory. High-profitability companies often exhibit high inventory turnover rates, reflecting efficiency in inventory management. Factors leading to reduced inventory turnover include weak sales or the accumulation of excess inventory within the organization (Ruichao, 2013). Studies such as those by Mansoor and Muhammad (2012) have found that reducing storage periods can enhance profitability, identifying this as a key factor in profit improvement. Other research has indicated an inverse relationship between profitability and the inventory cycle, demonstrating that reducing the number of days inventory is held plays a significant role in increasing corporate profitability (e.g., Falope & Ajilore, 2009; Mansoor & Muhammad, 2012). Conversely, some studies, such as that by Mathuva (2010), have shown a positive relationship between profitability and inventory turnover; maintaining optimal inventory levels can help mitigate costs associated with missed opportunities caused by product shortages. Meanwhile, excessive investment in inventory ties up working capital that could otherwise be utilized for other investment activities. Inventory management operations require coordinated and precise execution, as excessive inventory negatively impacts profitability in turn leading to lost opportunities and delays in sales to customers. Prolonged periods of inventory sitting on shelves clearly contribute to reduced profitability. Based on the preceding discussion, the following hypothesis has been formulated:

H1: There is a statistically significant relationship between inventory management and profitability

Liquidity Management and Its Relationship to Profitability

Liquidity refers to the funds held by companies that are relied upon to settle financial obligations or to fund other projects. It can be measured by dividing current assets by current liabilities. Managers must make various decisions regarding dividend distribution, financing, and investment activities. In the field of financial management, it is often observed that financial managers face pressure when attempting to balance liquidity and profitability (Eljelly, 2004). These cash funds are essential for companies to meet financial obligations and settle bills, or to finance unexpected purchases. Financial ratios serve as effective metrics for evaluating companies and their capacity to repay outstanding debts; they reflect the ability to convert assets into cash to settle financial obligations without negatively impacting the company's market value. Furthermore, operating cash flows indicate a company's capacity to reinvest in its assets (Ahmad et al., 2024), and these funds are also utilized to withstand financial shocks. Achieving profitability requires utilizing the liquidity held by institutions to drive profitable operations. These two concepts are inversely related, meaning an increase in one leads to a decrease in the other. Studies that Mekonnen (2011) have confirmed the existence of an inverse relationship between profitability and liquidity. Based on this, the following hypothesis has been formulated :

H2: There is a statistically significant relationship between liquidity management and profitability.

Short-term debt management and profitability

Increased reliance on short-term loans complicates corporate operations due to the associated financial burdens; consequently, companies must generate high profits to meet their financial obligations, as higher profitability expectations help mitigate risks that could otherwise jeopardize their financial and institutional standing (Poursoleiman et al., 2020). Some studies indicate that industrial firms often rely on short-term debt because it offers higher returns compared to long-term borrowing (Nguyen & Nguyen, 2020). Furthermore, research has found that the burden associated with short-term debt is lower than that of other forms of debt, thereby easing the

repayment process for borrowers. Additionally, a number of studies have concluded that short-term debt has a positive impact on profitability Samo & Murad (2019) and Nguyen & Nguyen (2020). Based on the foregoing, the following hypothesis has been formulated:

H3: There is a statistically significant relationship between short-term debt management and profitability.

The relationship between profitability and stock return

There is a wealth of information that can influence the incentives offered to investors in the form of shares. Return on Assets (ROA) has been adopted as a measure of profitability in analytical processes, as it evaluates a company's ability to generate net profit from its assets. High ROA ratios signal to investors that purchasing the company's shares is advisable, anticipating value appreciation driven by changes in net income; this encourages large-scale share purchases, thereby driving up share prices and enhancing shareholder investment returns. A study by Ayo et al. (2018) concluded that ROA plays a significant positive role in influencing stock returns, finding that higher ROA contributes to increased profits, which motivates investors to buy shares. Conversely, a study by Eugenia et al. (2023) indicated different results, suggesting that ROA does not impact stock returns. Meanwhile, a study by Lalu et al. (2024) found that ROA positively affects stock returns. Based on the foregoing, the following hypothesis has been formulated:

H4: There is a statistically significant relationship between profitability and stock returns.

Profitability as a Mediator in the Relationship Between Working Capital Management and Stock Return.

Profitability plays a clear and fundamental role as an intermediary between working capital and shareholder returns. Working capital management significantly influences shareholder returns by enhancing profitability performance. Effective management is crucial for achieving balance; Deloof (2003) established a link between working capital management and corporate profitability. Similarly, a study by Singh et al. (2017) confirmed this relationship, noting that it varies depending on the specific metrics used to measure profitability. High ROA ratios signal to investors that purchasing the company's shares is advisable, anticipating value appreciation driven by changes in net income; this encourages large-scale share purchases, thereby driving up share prices and enhancing shareholder investment returns. A study by Ayo et al. (2018) concluded that ROA plays a significant positive role in influencing stock returns, finding that higher ROA contributes to increased profits, which motivates investors to buy shares. Based on the preceding explanation, it can be assumed that working capital influences profitability and that profitability, in turn, affects the return on equity; this suggests that profitability may act as a mediating variable in this relationship. Accordingly, the following hypothesis can be formulated:

H5: The profitability mediates the relationship between of Liquidity management and stock return.

H6: The profitability mediates the relationship between of Short-term debt management and stock return.

H7: The profitability mediates the relationship between of Inventory management and stock return.

Conceptual Framework

The current study examines the impact of profitability as a mediating variable between financial leverage management and stock returns. Three variables were used to measure the independent

variable working capital management namely: liquidity management, inventory management, and short-term debt management. Profitability was employed as the mediating variable, measured using Return on Assets (ROA), while the dependent variable is stock return. Figure (1) illustrates the direct and indirect relationships among the study variables.

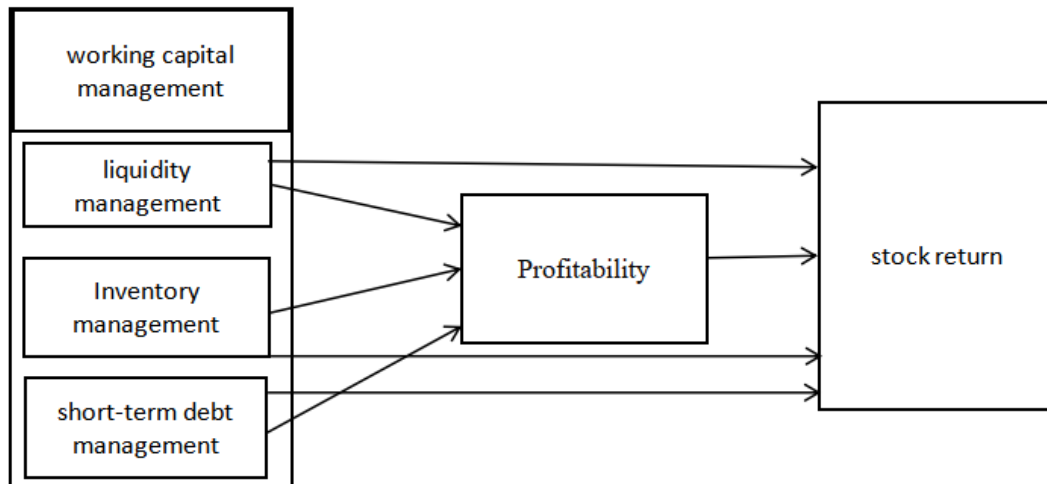


Figure (1): Conceptual Framework.

Data Collection

The study adopted a descriptive-analytical approach, which comprises both theoretical and practical components. The practical aspect focuses on analytical and logical processes, while the theoretical aspect centers on secondary data to identify variables and the nature of the relationships between them. Specifically, the study utilized secondary data covering listed companies in the In companies listed on Bursa Malaysia from 2014 to 2024 incorporating profitability as a mediating variable, working capital as an independent variable, and return on shares as the dependent variable. Data analysis was conducted using the SPSS and Smart PLS software packages to perform all necessary analyses.

Statistical Tests

To achieve the intended results, the researcher focused on conducting a set of essential analyses based on historical data. Multiple software programs were utilized for these analytical processes, specifically SPSS (Version 26) and Smart PLS. The analyses encompassed key tests, including correlation analysis, as well as the assessment of direct and indirect effects incorporating mediation analysis alongside calculations of arithmetic means and variance.

The analysis of Correlation

Table No. (1) shows the correlation results which is related to the study variables.

N		LM	IM	STDM	ROA	SR
1.	LM	1	-0.31	-0.32	0.54	0.32
2.	IM	-0.31	1	0.34	-0.42	-0.22
3.	STDM	-0.32	0.34	1	-0.44	-0.33

4.	ROA	0.54	-0.42	-0.44	1	0.56
5.	SR	0.32	0.22	-0.33	0.56	1

The table above reveals varying values. It shows a positive correlation between liquidity management and profitability (0.54), as well as a positive correlation with return on shares (0.32), indicating that effective liquidity management is favorably linked to both profitability and return on shares. Regarding inventory management, the table shows a negative correlation with return on assets (-0.42) and a negative correlation with return on shares (-0.22). Short-term debt management also exhibits a negative correlation with profitability (-0.44). While the relationship with return on equity is also positive, it is weaker, with a value of -0.33. Finally, the relationship between the mediating variable profitability and return on shares is positive, registering the highest value at 0.56.

Table (2): Results of the impact of capital management on return on equity, taking profitability as an intervening variable

Paths	Expected signal	Unstandardized Coefficient	Standardized Coefficient	Std. Err.	z stats.	p > z
LM> ROA	+	0.021	0.554	0.003	5.55	0.000
IM.....>ROA	-	-0.030	-0.442	0.008	-3.52	0.000
STDM.....>ROA	-	-0.013	-0.540	0.003	-3.50	0.000
LM.....>SR	+	0.025	0.332	0.011	2.27	0.023
IM.....>SR	-	-0.010	-0.230	0.004	-2.33	0.021
STDM.....>SR	-	-0.024	-0.42	0.007	-3.43	0.000
ROA.....>SR	+	0.521	0.645	0.082	6.32	0.000

Table (2) reveals a positive relationship between liquidity management and the profitability of the companies listed on Bursa Malaysia included in the study. A favorable relationship between the two facilitates the achievement of established goals; the unstandardized coefficient was 0.21, the standard error was 0.554, and the Z-value was 5.55 (statistically significant at $p < 0.001$). This result clearly indicates a positive relationship, where increased liquidity is associated with increased profitability. Regarding the relationship between inventory management and profitability, the results show a negative relationship; the unstandardized coefficient was -0.003, the standard error was 0.442, and the Z-value was -3.52 (statistically significant at $p < 0.001$). Similarly, the relationship between short-term loan management and profitability is negative; the unstandardized coefficient was -0.013, the standard error was 0.540, and the Z-value was -3.50 (statistically significant at $p < 0.001$). while the relationship between liquidity management and stock returns is positive; the unstandardized coefficient was 0.25, the standard error was 0.332, and the Z-value was 2.27 (statistically significant). The relationship between inventory management and stock return is negative; the unstandardized coefficient is -0.01, the standardized coefficient is -0.230, and the Z-value is -2.33 (statistically significant). Similarly, the relationship between inventory management and stock return is negative, with an unstandardized coefficient of -0.024, a

standardized coefficient of -0.420, and a Z-value of -3.34 (statistically significant). As for the relationship between the mediating variable profitability and stock return, it is a strong positive relationship; the unstandardized coefficient is 0.521, the standardized coefficient is 0.645, and the Z-value is 6.32 (statistically significant).

Table (3): Goodness-of-fit statistics

	R squared	Wald test for goodness fit			Stability analysis	
		χ^2 Stats.		p-value	Eigenvalue	Modulus
Observed:						
Profitability	55.4%	157.32		0.000**	0	0
Stock Return	39.3%	16.45		0.000**	0	0
Stability index = 0						

As shown in Table 3, the results indicate that working capital management explains 55.4% of the variance in profitability. Regarding the shared variance between working capital management and profitability, it accounts for 39.3% of the stock returns of companies listed on the Istanbul Stock Exchange, while any remaining variance is attributed to random errors stemming from managerial factors and measurement inaccuracies.

Table (4): Formal mediation test

Path	Sobel test	RIT	RID	Mediation type
Liquidity management →Profitability→Stock Return	0.241 [3.342]**	0.285	0.376	Partial Mediation
Inventory management →Profitability→Stock Return	-0.182 [- 3.077]**	0.342	0.345	Partial Mediation
Short-term debt management→ Profitability→Stock Return	-0.223 [- 3.623]**	0.323	0.353	Partial Mediation

Based on the Sobel analysis presented in Table 5 which relies on the three-step informal methodology developed by Baron and Kenny the test results indicate statistical significance for liquidity management, inventory management, and short-term loan management. The mediating effect observed across all variables was partial regarding all dimensions of working capital management. Furthermore, the RIT values for liquidity management, inventory management, and short-term debt management were 0.285, 0.342, and 0.323, respectively. The RID results show a mediating effect value of 0.376 for liquidity management, 0.345 for inventory management, and 0.353 for short-term loan management.

Conclusion

This study aims to examine the role of profitability as a mediating variable between working capital management dimensions and stock returns on the Malaysian stock exchange. Profitability is considered a key factor capable of significantly moderating the direct impact of working capital management. Analysis results indicate that working capital dimensions have varying effects on

profitability and stock returns; specifically, liquidity management exerts a positive and statistically significant influence on both. Conversely, the impact of inventory management on profitability and stock returns was found to be negative and statistically significant. Similarly, the relationship between short-term debt management, profitability, and stock returns was negative and statistically significant. Regarding the mediating role of profitability, the findings reveal a partial mediation effect between liquidity management and stock returns, as well as between inventory management and stock returns. Furthermore, the results demonstrate a partial mediation effect of profitability on the relationship between short-term debt management and stock returns.

Profitability exerts a significant positive influence on stock returns and is regarded as a key financial indicator that investors take seriously when evaluating performance and making decisions. Furthermore, profitability plays a crucial role in generating earnings through the efficient use of available resources. Corporate profitability significantly mitigates institutional risk by bolstering investor confidence and driving up demand for shares; this, in turn, increases market value and further boosts earnings. Market dynamics have clearly impacted companies listed on the Malaysian stock exchange, revealing tangible fluctuations in profit levels during periods of instability. The findings also indicate that poor or inefficient financial management hinders the achievement of desired objectives. Consequently, treating profitability as a mediating variable is vital, given its significant role in facilitating the relationship between working capital management and stock returns.

This study contributes to existing market knowledge by deepening the understanding of working capital management, profitability, and stock returns within the context of the Malaysian stock exchange. It highlights the mediating role of profitability in the relationship between working capital management and stock returns. Additionally, it fosters a better understanding of optimal management practices and addresses the operational inefficiencies that often lead to the failure of financial institutions. These findings underscore the importance of sound financial management regarding working capital. Ultimately, this research offers practical applications while simultaneously addressing existing research gaps. Theoretically, this study contributes to enriching the scholarly literature related to the study's variables, while also allowing for the testing of theories across diverse research contexts. Furthermore, the study is expected to offer evidence-based recommendations and proposals, thereby helping to enhance the development of policies and practices relevant to the subject matter.

Suggestions

Based on the study's findings, companies listed on Bursa Malaysia need a deeper understanding of the mechanisms and strategies they employ to manage working capital. Profitability must be considered a mediating variable, as it is a fundamental pillar enabling companies to adapt to market fluctuations over time. Furthermore, profitability plays a vital role in enhancing shareholder returns by optimizing the management of the three key working capital variables. Emphasis should also be placed on utilizing historical data to guide future operations and management strategies, thereby maximizing profits and mitigating risks.

Given the confirmed relationship between working capital management and shareholder returns mediated by profitability financial managers must focus on these variables, which are crucial to profit generation. Companies need to adopt approaches aligned with their internal and external environments to ensure optimal management, maximize shareholder returns, and avoid risks associated with poor management. Additionally, companies should manage their available funds with greater flexibility and fluidity, enabling them to adapt effectively to sudden market changes.

Finally, management at all levels must work on developing skills in a flexible and effective manner to achieve desired profit targets.

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