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The Impact of Defensive and Offensive Business Strategies on the Relationship Between Working Capital Management and Profitability

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Abstract

Objectives: This research aims to investigate the impact of working capital management on the profitability of firms, emphasizing the moderating role of defensive and offensive business strategies. Effective management of working capital is essential for the survival of firms, as it reflects the efficient use of short-term capital and serves as a crucial measure of liquidity.

Methodology/Design/Approach: This applied study employs a causal correlational methodology (post-event). The statistical population comprises all firms listed on the Tehran Stock Exchange. Due to specific constraints, a total of 135 firms were selected through systematic elimination sampling and analyzed over ten years from 2014 to 2023.

Finding: The results indicate that aggressive business strategies significantly moderate the relationship between working capital management and firm profitability, whereas defensive strategies do not exhibit a notable effect on this relationship.

Innovation: This research contributes to the understanding of how business strategies influence the relationship between working capital management and profitability. It provides actionable recommendations for firms to adopt aggressive strategies to enhance overall performance. Furthermore, given the unstable economic environment in the country, it is suggested that firms develop strategic plans to improve their responsiveness to threats and capitalize on emerging opportunities.

Keywords: Working Capital Management, Profitability, Defensive and Offensive Business Strategy.

1. Introduction

Profitability is closely related to profits but differs in a key aspect: while profit represents an absolute value, profitability is a relative measure. This criterion assesses the extent of a company's profits relative to its size (Eskandarnejad et al., 2020). Profitability serves as an indicator of productivity and ultimately reflects the success or failure of a business. A more precise definition of profitability is the company's ability to generate financial returns based on its available resources compared to alternative investment opportunities. However, this does not necessarily imply that the company is profitable in practice (Sajadi et al., 2007).

Profit is one of the most significant components of financial statements, and users of such statements typically attach great importance to it. In accounting literature, the concept of profit has been widely debated, and there is no universally accepted, comprehensive definition due to differing expert perspectives.

Working capital management involves the administration of current assets and current liabilities. It aims to strike a balance between them, enabling shareholders to maximize returns on assets through the effective use of working capital. Efficient working capital management is crucial for the survival of companies, as it reflects the firm's ability to manage short-term capital and liquidity. Liquidity, in turn, is vital for ensuring the firm can meet its short-term obligations, as inadequate liquidity may lead to bankruptcy.

Effective management of working capital requires a balance between liquidity and profitability to maximize firm value. For example, maintaining larger inventories can help prevent disruptions in production or the procurement of expensive raw materials (Eskandarnejad et al., 2020). Additionally, extending credit to customers can stimulate sales and allow them to assess product quality before payment. However, such practices also reduce the available cash for investment, implying that achieving an optimal level of working capital can be a complex challenge for managers.

In Iranian companies, working capital management is particularly significant due to constraints in accessing long-term capital markets. These companies often rely on internal financial sources such as short-term bank loans, credit sales, inventory investment, cash holdings, and accounts receivable. Given such financial limitations, effective working capital management offers a practical strategy for Iranian firms (Badavarnahdi & Taghizadeh Khanqah, 2016).

Profit generation remains the fundamental goal of firms and commercial enterprises. In order to retain investor and stakeholder satisfaction, it is essential to enhance their wealth through sustained profitability. Consequently, studying the factors that influence corporate profitability is of considerable importance.

Working capital—defined as the short-term capital required in a company's operating cycle from raw material procurement to product sales and revenue collection—plays a crucial role. Inadequate working capital can disrupt the operating cycle and reduce profitability, while excess working capital may tie up resources and potentially create future financial problems.

Working capital management has been recognized in prior studies as a significant factor in influencing profitability. The current research places additional emphasis on how a firm's business strategy—defensive or aggressive—moderates this relationship. When a company adopts an aggressive strategy and enters a highly competitive environment, it must have stronger operational support. A faster operating cycle is typically required for such strategic moves, necessitating adjustments in working capital management, which in turn may affect profitability.

Conversely, companies with defensive strategies, such as those in the real estate sector that aim for stability, may face less risk related to working capital. Therefore, due to inconclusive prior findings and the identified research gap in domestic studies, examining the moderating role of defensive and offensive strategies in the relationship between working capital

management and profitability is both relevant and necessary. Accordingly, the purpose of this study is to investigate how different business strategies influence the relationship between working capital management and profitability.

Theoretical Foundations of Research

Working Capital Management and Profitability

Profitability refers to a company's ability to generate income and sustain profits. Net income, or net profit, serves as a key indicator of this profitability. Investors and creditors are highly interested in assessing both the current and future profitability of firms, as consistent profitability is essential for providing satisfactory returns and securing the capital necessary for growth. Companies that fail to generate sufficient profits are unlikely to attract investments or loans required for implementing various projects. In this context, the long-term sustainability and survival of a firm depend largely on its ability to generate earnings that fulfill obligations and reward key stakeholders (Osulian et al., 2016).

Given this, identifying the determinants of profitability is critical. One such determinant is the method of managing working capital. In today's volatile economic environment—characterized by heightened environmental pressures and limited access to external financing—working capital, comprised of current assets and liabilities, plays a vital role. Effective working capital management not only represents a potential competitive advantage but also directly influences a firm's financial performance, profitability, and liquidity (Le, 2019).

Working capital management encompasses the short-term financing of investment activities and typically constitutes a substantial portion of a company's balance sheet across various industries. When managed effectively, it can significantly enhance corporate performance (Nastiti et al., 2019).

According to Jensen and Meckling's (1976) agency theory, working capital indicators are aligned with the metrics used to measure a company's operating cycle, also referred to as the cash conversion cycle. This cycle spans the period between the outflow of cash for material purchases and the inflow of cash from product sales. A longer cash conversion cycle implies more capital invested in working capital, potentially resulting in liquidity constraints. However, a well-managed cash conversion cycle can also lead to increased sales and ultimately greater profitability (Barros et al., 2021).

Business Strategy, Working Capital Management, and Profitability

A prolonged cash conversion cycle can adversely affect a company's profitability. Firms that tie up excessive funds in working capital—resources that could otherwise be invested in productive ventures—often face increased financing costs. Conversely, companies with more efficient working capital management, requiring less investment in current assets, are generally more profitable.

In broader terms, strategy represents an organization's roadmap toward achieving its long-term objectives. In management theory, strategy formulation is a critical function, forming the foundation for decisions that ensure organizational sustainability and growth. A well-crafted strategy not only responds effectively to external environmental conditions but also aligns with internal capabilities and the strategies implemented at other organizational levels. Strategic coherence and integration across corporate, business, and functional levels are essential for achieving overall success (Izedi, 2013).

Companies typically adopt either **offensive (aggressive)** or **defensive** business strategies. Defensive firms aim to establish and maintain a secure market position, often within stable industries. These firms tend to offer a narrow product or service range and seek to maintain competitiveness through lower prices, higher quality, or superior service. They generally avoid taking the lead in innovation or entering unfamiliar markets, preferring to resist changes that do not directly affect their core operations (Marfouf & Shakeri, 2018).

In contrast, aggressive firms emphasize innovation, creativity, and proactive market engagement. Such a strategy is particularly suitable in dynamic and highly competitive environments. For these companies, market penetration and technological advancement often take precedence over short-term profitability. As a result, organizational strategic orientation—whether offensive or defensive—can significantly influence a firm's financial reporting practices and overall financial performance (Hajiha & Ranjbarnavi, 2018).

Research Background

Delgosha and Raei Ezabadi (2023), in their study titled *"The Role of Financial Constraint in Determining the Relationship between Working Capital and Financial Performance"*, found a significant negative relationship between working capital and financial constraints with the financial performance of companies. Although the moderating role of financial constraints in this relationship was negative, it was not statistically significant.

In their research titled *"Investigating the Relationship between Working Capital Management in Boom and Recession Periods"*, Ghodrati Zavarem et al. (2022) revealed that during periods of economic recession, managers tend to adopt conservative working capital policies, whereas during inflationary periods, more aggressive working capital management strategies are implemented.

Mazaheri and Shokrizadeh (2021), in their study *"Investigating the Effect of Working Capital Management on Stock Liquidity"*, emphasized that working capital management plays a key role in corporate finance, particularly in affecting the liquidity of stocks. Their findings confirmed a significant relationship between working capital management and stock liquidity.

Asadi et al. (2021), in *"The Moderating Role of Business Strategy on the Relationship between Social Responsibility and Firm Performance"*, found that corporate social responsibility positively impacts economic and market value, and this relationship is significantly enhanced by an aggressive business strategy. The results suggest that firms with more aggressive strategies experience a stronger link between social responsibility initiatives and firm performance.

Nabavi Chashemi et al. (2021), in a study titled *"Investigating the Relationship between Managers' Ability and Working Capital Management"*, found that managerial ability extends the cash conversion cycle and inventory turnover period. Moreover, a significant negative relationship exists between managerial ability and the accounts payable period.

Esmailzadeh et al. (2020), in *"Identifying Business Strategies to Face Environmental Uncertainties: A Review Study"*, identified 203 basic strategic responses to uncertainty, categorized into 29 organizing themes, which were further condensed into four overarching strategies: foresight, adaptation, acceptance, and moderation. This framework aids managers in selecting appropriate strategies to respond to environmental uncertainty.

Wallismas (2023), in his study *"The Moderating Effects of Strategy in Relation to Working Capital Management with Profitability"*, reported that aggressive strategies have a diminishing moderating effect, while defensive strategies have an enhancing moderating effect on the relationship between working capital management and profitability.

Tarcom (2022), in *"The Impact of COVID-19 on Working Capital Management: The Moderating Effect of Investment Opportunities and Government Incentives"*, found that the adverse effects of the pandemic on working capital management could be mitigated by increasing investment opportunities and government incentives.

Rodiavarni et al. (2022), in *"Business Strategy and Competition in Industries"*, concluded that aggressive firms outperform defenders financially for up to two years post-strategy implementation. Furthermore, innovative firms perform better than defenders in highly competitive environments, underlining the need for strategic alignment in such conditions.

Finally, Selaigua (2022), in a study on Czech firms titled *"Working Capital Management and its Impact*

on the Size and Profitability of Companies", demonstrated that factors such as the cash conversion cycle, current asset ratio, current liabilities ratio, and working capital ratio significantly influence the profitability of firms in the manufacturing, wholesale, and retail sectors.

Research Hypotheses

Based on the theoretical foundations and empirical literature, the following research hypotheses are proposed:

H1: Aggressive business strategy has a significant moderating effect on the relationship between working capital management and profitability.

H2: Defensive business strategy has a significant moderating effect on the relationship between working capital management and profitability.

Research Methodology

The present study is **applied** in terms of its purpose, aiming to address practical problems related to corporate financial performance and strategic management. Regarding the **research method**, it adopts a **descriptive-causal** approach, seeking to describe relationships between variables and examine causal effects, particularly the moderating role of business strategy on the relationship between working capital management and profitability.

In terms of **data collection**, the study is of the **historical (ex post facto)** type, meaning that it relies on past data to analyze relationships among variables. The method of gathering data is **library-based**, involving the use of existing financial statements, reports, and other archival records.

To test the research hypotheses, **regression analysis** will be employed after selecting the sample firms and collecting the required data. For data processing and analysis, **Excel** spreadsheet software has been used for initial organization, and **EViews** software has been utilized for statistical and econometric analyses.

The **spatial scope** of the research includes all firms listed on the **Tehran Stock Exchange (TSE)** during the period **2014 to 2023**. Based on the defined criteria and research limitations (such as data availability and consistency), a final sample of **135 companies** has been selected for empirical analysis.

Operational Definitions of Research Variables

Research Dependent Variable: Profitability (ROA)

Profitability, according to the research of Willismas (2023), is derived from the ratio of net profit to total assets.

Independent Variable: Working Capital Management (WCM)

According to the studies of Eskandar Nejad et al. (2020) and Badavar Nahandi and Taghizadeh Khanqah (2016), the main components of working capital—namely accounts receivable, inventory, accounts payable, and the efficient use of cash in operational activities—have been utilized as indicators to represent working capital management, which is treated as the dependent variable in this research. Specifically, the study employs the cash conversion cycle (CCC) and its constituent elements to quantify working capital performance.

The cash conversion cycle reflects the average time required for a company to convert its investments in inventory and other resources into cash flows from sales. It includes three core components:

- Accounts Receivable Period (ARP): the average number of days required to collect payments from customers;
- Inventory Period (INVP): the average time goods remain in inventory before being sold;
- Accounts Payable Period (APP): the average duration the firm takes to pay its suppliers.

In the regression models and hypothesis testing of this study, each component of the cash conversion cycle is also individually examined as a dependent variable to provide a more detailed understanding of working capital dynamics, consistent with the approach of Bolo et al. (2012).

$$CCC = \left(\frac{\frac{AR_t + AR_{t-1}}{2}}{\frac{Sales}{365}}\right) + \left(\frac{\frac{INV_t + INV_{t-1}}{2}}{\frac{COGS}{365}}\right) - \left(\frac{\frac{AP_t + AP_{t-1}}{2}}{\frac{Purchases}{365}}\right)$$

In the above relationships:

CCC: Cash Conversion Cycle

Sale: Net Selling

COGS: Cost of Goods Sold

Purchases: The cost of the goods sold plus the inventory at the end of the period minus the first item of the period.

AR: Accounts Receivable

INV: Inventory

AP: Accounts Payable

Moderating Variable: Business Strategy (Defensive (DEF) and Offensive (PRO))

In the present study, and in line with the methodologies adopted by Hrosita and Suryadinata (2022), Rostami et al. (2021), and Tanani and Mohebkhah (2014), the combined scoring model of Ittner and Larcker (1997) is employed to determine the strategic orientation of each company. This scoring approach is based on five financial and operational ratios:

1. Sales growth rate,
2. Advertising expense to total sales,
3. Number of employees to sales,
4. Market value to book value, and
5. Fixed assets ratio.

To implement the scoring system, the companies are first divided into quintiles (five equal groups) for each of the first four ratios. Companies in the top quintile receive a score of 5, while those in the lowest quintile receive a score of 1. The remaining companies are scored proportionally based on their respective quantiles.

For the fifth ratio (fixed assets ratio), the scoring is reversed: companies in the top quintile receive a score of 1, and those in the lowest quintile receive a score of 5, again with the rest assigned proportionally.

In the final step, the scores across all five indicators are summed to calculate each company's combined strategy score, which ranges from 5 to 25. Based on this aggregate score:

- Companies scoring between 5 and 15 are classified as following a defensive strategy,
- Companies scoring between 15 and 25 are considered to follow an aggressive strategy.

Accordingly, the moderating variable in this research is treated as a binary (dummy) variable:

- If a company adopts either an aggressive or a defensive strategy, it is coded as 1,
- Otherwise, it is coded as 0.

Table 1 - How to Score Business Strategy

punjak	Sales Growth Rate	Advertising Cost	Number of Employees	Company Market Value	Fixed Assets
		Total Sales	Total Sales	Book Value of the Company	Total Assets
1	5	5	5	5	1
2	4	4	4	4	2
3	3	3	3	3	3
4	2	2	2	2	4
5	1	1	1	1	5

Research Control Variables

Company size (SIZE): The natural logarithm of total assets.

Sales Growth (SG): The sales of the current period minus the sales of the previous period divided by the sales of the previous period.

Financial Leverage (LEV): The ratio of total liabilities to total assets.

Liquidity Ratio (OCF): The ratio of operating cash to total assets.

Capital Intensity (FA/TA): The ratio of fixed assets to total assets.

Research Regression Model

Following the research of Walismas (2023), the model has been introduced as follows to test the research hypotheses.

$$\begin{aligned} \mathrm{ROA_{it}} = {} & \beta_0 + \beta_1 \mathrm{WCM_{it}} + \beta_2\, \mathrm{PRO_{it}} + \beta_3\, \mathrm{DEF_{it}} \\ & + \beta_4(\mathrm{WCM_{it}} \times \mathrm{PRO_{it}}) \\ & + \beta_5(\mathrm{WCM_{it}} \times \mathrm{DEF_{it}}) \\ & + \beta_6\, \mathrm{SIZE_{it}} + \beta_7 \mathrm{SG_{it}} + \beta_8\, \mathrm{LEV_{it}} \\ & + \beta_9\, \mathrm{OCF_{it}} + \beta_{10}\, \mathrm{FA/TA} + \varepsilon_{it} \end{aligned}$$

Research Findings

The presented descriptive statistics related to 135 sample companies in the 10 years (2013-2022) or (1350-firm-years) are presented in Tables 3 and 4.

The primary measure of central tendency used in this study is the mean, which represents the equilibrium point and the center of gravity of the distribution, serving as a reliable indicator of the data's centrality. For instance, the mean value of the leverage variable is 0.55, indicating that most data points are concentrated around this value. Dispersion measures are essential for assessing the extent to which data values spread out or deviate from the mean. Among these, the standard deviation is one of the most important indicators of dispersion. In this research, the standard deviation for working capital management is 243.2, reflecting a high degree of variability, whereas the standard deviation for company liquidity is 0.12, indicating relatively low variability. Additionally, the minimum and maximum values for each variable provide insight into the range of data by indicating the lowest and highest observed values, respectively.

Table 2- Descriptive statistics of research variables

Variable	Mean	S. dev.	Min.	Max.
ROA	0.14	059	-0.22	0.15
WCM	313.08	682.00	79.24	243.2
SIZE	14.91	20.00	11.40	1.67
Sg	0.38	2.13	-0.39	0.46
LEV	0.55	1.01	0.10	0.20
OCF	0.11	0.48	-0.14	0.12
FA/TA	0.26	0.68	0.019	0.17

Table 3- Frequency Distribution of Business Strategy Variable

Variable	Value	Frequency	Percent Frequency
PRO	1	605	44.81
DEF	0	745	55.19
Total	-	1350	100

As can be seen in Table 3, the total year of the companies under study is equal to 1350, among which 605 years - companies equivalent to 44.81% of the year - companies have an aggressive strategy and 745 firm-years—i.e., 55.19% of the year - companies have a defensive strategy.

According to the results obtained in Table 4, it can be seen that the significance level of the variables in

the durability test is less than 5% and indicates the reliability of the variables.

According to the results obtained in Table 5, it can be seen that the significance level of the Chow test for the research model is less than 5% and indicates the acceptance of the panel data model, which requires the presentation of the Hausman test, which is presented below (Platouni, 2018).

According to the results obtained in Table 6, it can be seen that the significance level of the Hausman test in the research model is less than 5% and indicates the acceptance of fixed effects.

***Table 4*- Stability Test Quantity Variables**

Variable	Test Statistics	Sig	Results
ROA	-5.31733	0.0000	Stationary
WCM	-23.6722	0.0000	Stationary
SIZE	-18.3167	0.0000	Stationary
Sg	-2.59579	0.0000	Stationary
LEV	-8.81136	0.0000	Stationary
OCF	-11.1637	0.0000	Stationary
FA/TA	-8.94694	0.0000	Stationary

Table 5 - F-Limmer test results

Test Model	Test Statistics	Sig
Research Model	2.9543	0.0000

Table 6 - Results of the Hausman Test

Test Model	Test Statistics	Sig
Research Model	172.73	0.0000

Table 7- The result of the hypothesis test

$$ROA_{it} = \beta_0 + \beta_1 WCM_{it} + \beta_2 PRO_{it} + \beta_3 DEF_{it} + \beta_4 (WCM_{it} \times PRO_{it}) + \beta_5 (WCM_{it} \times DEF_{it}) + \beta_6 SIZE_{it} + \beta_7 SG_{it} + \beta_8 LEV_{it} + \beta_9 OCF_{it} + \beta_{10} FA/TA + \varepsilon_{it}$$

Dependent Variable: Profitability

Variables	Coef	Std	Statistic t	Sig	VIF
WCM	0.024	0.010	2.37	0.017	2.22
PRO	0.012	0.008	1.45	0.14	3.20
DEF	0.0003	0.007	0.048	0.96	1.08
WCM× PRO	0.016	0.007	2.27	0.023	3.54
WCM× DEF	0.011	0.006	1.79	0.072	1.06
SIZE	0.034	0.005	6.24	0.0000	1.47
Sg	0.034	0.005	6.91	0.0000	1.26
LEV	-0.40	0.019	-20.8	0.0000	1.10
OCF	0.13	0.021	6.36	0.0000	1.06
FA/TA	-0.35	0.019	-18.11	0.0000	1.37
C	-0.13	0.084	-1.62	0.10	-
AR(1)	0.37	0.10	3.53	0.0004	-
Coefficient of determination	0.90				
Watson Durbin	1.96				
F	70.1126				
Sig	0.0000				

The results presented in Table 7 indicate that the interaction between working capital management and aggressive business strategy has a positive and significant effect on firm profitability, with a coefficient of 0.016 and a significance level of 0.023 (less than 5%). Therefore, the first research hypothesis is accepted at the 5% significance level. Conversely, the interaction between working capital management and defensive business strategy, with a significance level of 0.072 (greater than 5%), does not have a significant effect on profitability. Hence, the second hypothesis is rejected at the 5% significance level.

The model's coefficient of determination (R^2) is 0.90, indicating that the independent and control variables collectively explain 90% of the variance in the dependent variable (firm profitability). Additionally, the Durbin-Watson statistic is 1.96, which lies within the acceptable range of 1.50 to 2.50, suggesting no significant autocorrelation problem in the residuals. The variance inflation factor (VIF) values are all below 5, confirming the absence of multicollinearity among the research variables. Finally, the F-test statistic is significant at less than 5%, indicating that the overall regression model has a good fit and is statistically reliable.

Research Results

As previously noted, the main objective of this study is to examine the moderating role of business strategies—specifically defensive and aggressive strategies—on the relationship between working capital management and profitability. In general terms, a strategy is a comprehensive plan and vision for future goals that an organization develops and implements to achieve its objectives. In management science, however, strategy formulation is considered one of the most critical functions of management, serving as the foundation for key decisions that ensure the survival and long-term success of the organization.

In the contemporary business environment, most organizations no longer rely solely on a unified, overarching strategy. Instead, they adopt a portfolio of strategic approaches, each designed and implemented at different organizational levels. Among these, business-level strategy plays a pivotal role in determining how a company responds to industry, economic, and political changes to achieve and sustain a competitive advantage. It represents a management plan tailored to a specific area of the organization's operations, guiding the optimal allocation of resources to secure strong performance outcomes within that business domain.

Companies typically pursue either aggressive or defensive strategies, depending on their capabilities and objectives. According to the findings of this study, it was observed that an aggressive business strategy has a significant moderating effect on the relationship between working capital management and profitability. Firms adopting an aggressive strategic posture—characterized by proactive market penetration, innovation, and resource commitment—are more likely to enhance their financial performance by expanding market share and strengthening their competitive position. Consequently, the interaction between efficient working capital management and profitability is amplified in companies pursuing aggressive strategies.

In contrast, defensive strategies—which emphasize cost control, risk avoidance, and stability—did not demonstrate a significant moderating effect on the relationship between working capital management and profitability in this study. These results diverge from the findings of Walismas (2023), who concluded that business strategy, in general, does influence the working capital–profitability relationship.

Based on the findings related to the first hypothesis, it is recommended that companies with greater competitive potential adopt aggressive strategies to enhance overall performance. These strategies may enable firms to better utilize their working capital and improve profitability. Regarding the second hypothesis, which indicated that defensive strategies do not significantly impact the working capital–profitability relationship, it is suggested that firms operating in volatile economic environments focus on proactive planning to enhance profitability.

By doing so, they can better respond to external threats and potentially convert them into opportunities for strategic growth.

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