THE IMPACT OF WORKING CAPITAL POLICIES ON THE FINANCIAL PERFORMANCE OF NIGERIAN MANUFACTURING FIRMS DURING AN ECONOMIC DOWNTURN (2019–2023)

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Keywords

Working Capital Management, Aggressive Financing Policy, Aggressive Investment Policy, Financial Performance, Nigerian Manufacturing Firms, Economic Downturn

Abstract

Research Problem
This study investigates the impact of working capital policies on the financial performance of Nigerian manufacturing firms listed on the Nigerian Stock Exchange from 2019 to 2023, a period marked by economic adversity, including the COVID-19 pandemic. Despite the importance of working capital management in ensuring liquidity, many Nigerian manufacturing firms struggle with profitability, exacerbated by suboptimal working capital policies during economic downturns.
Methods/Theory
A correlational research design and panel data econometric techniques were used to examine the effects of aggressive investment policy (AIP) and aggressive financing policy (AFP) on Return on Assets (ROA), Return on Equity (ROE), and Tobin's Q. The study was grounded in the Trade-Off Theory, Pecking Order Theory, and Cash Conversion Cycle (CCC) Theory.
Results
The findings revealed that an aggressive financing policy significantly

positively influenced ROE and Tobin's Q, suggesting that firms using higher levels of short-term financing achieved better profitability and market valuation. In contrast, an aggressive investment policy negatively impacted both ROA and ROE, indicating that overemphasis on current assets may reduce profitability.

Conclusion

The study concluded that aggressive financing policies enhance profitability and market value, while overly aggressive investment policies, which minimize current assets, can hinder firm performance, particularly in the Nigerian manufacturing context.

Key Contribution to Knowledge

This research highlights the need for a balanced approach to working capital management, particularly in periods of economic downturn.

Recommendation

It is recommended that manufacturing firms in Nigeria adopt a balanced strategy, optimizing investments in current assets while avoiding excessive reliance on aggressive financing.

1. Introduction

Working capital management (WCM) is a core aspect of corporate finance, particularly within the manufacturing sector, where efficient management of current assets and liabilities directly impacts liquidity, profitability, and sustainability. At its essence, working capital policy dictates how firms manage their short-term assets; such as cash, receivables, and inventories and their short-term liabilities, aiming to ensure the availability of resources to meet operational demands. The concept, as defined by Afza and Nazir (2009), involves strategies that minimize risks associated with liquidity, ensuring firms maintain an optimal balance between being over-liquid (which can result in inefficiencies) and under-liquid (which can hinder operations and expose firms to insolvency risks).

Historically, the effectiveness of working capital management in emerging markets like Nigeria has been under scrutiny, especially as firms face external economic shocks such as inflation, currency devaluation, and high financing costs. The period from 2019 to 2023 in Nigeria has been particularly challenging for manufacturing firms, as they grappled with the global economic downturn induced by the COVID-19 pandemic, which disrupted supply chains, raised operational costs, and escalated financing costs. In Such a volatile environment, managing working capital has become critical for firms to navigate these challenges and ensure continued operation.

Despite the widely acknowledged importance of working capital policies, existing literature reveals mixed results regarding their impact on financial performance. While studies by Afza and Nazir (2009) and Arnold (2015) suggest a positive relationship between sound working capital management and profitability, others such as Onwumere et al., (2015) highlight the negative consequences of adopting overly aggressive working capital policies . This dichotomy stems from the inherent risks associated with managing working capital, where aggressive investment and financing policies, although potentially more profitable, expose firms to liquidity challenges, particularly in unpredictable markets. The gap in existing literature lies in the limited empirical analysis of

working capital policies specifically within the Nigerian manufacturing context during periods of economic uncertainty. Most studies, such as those by Raheman and Nasr (2014), focus on broader market conditions, often overlooking the sector-specific dynamics or the specific challenges faced by manufacturing companies in emerging economies like Nigeria

This study seeks to fill this gap by focusing on two critical components of working capital policy, thus; Aggressive Investment Policy (AIP) and Aggressive Financing Policy (AFP) and investigating their effects on the financial performance of Nigerian manufacturing firms between 2019 and 2023. By narrowing the scope to this specific period, the study aims to provide insights into how these policies affected firm performance amidst Nigeria's economic turmoil.

This research also stands to contribute to the ongoing debate about the optimal working capital strategy for firms operating in developing economies. While some scholars advocate for conservative approaches to mitigate risks, others stress the profitability gains from aggressive strategies, particularly in stable economic periods. The Nigerian case, however, remains underexplored in this context, particularly with regard to how these strategies fared during economic downturns. As such, the findings of this study will not only enrich the academic literature but also provide actionable insights for policymakers and business leaders in Nigeria.

The paper is structured as follows: following this introduction, Section 2 presents a review of related literature. Section 3 outlines the methodology. Section 4 provides the data analysis, findings, and discussion. Finally, Section 5 concludes the paper with implications and recommendations.

Research Problem

The effective management of working capital is a fundamental determinant of financial performance in manufacturing firms. However, despite the well-documented importance of working capital management (WCM) in sustaining operational liquidity and profitability, Nigerian manufacturing firms continue to face significant challenges in optimizing their working capital policies. This inefficiency in working capital management is particularly noticeable during periods of economic decline, such as the 2019–2023 period in Nigeria, which saw high inflation, exchange rate volatility, and financial uncertainty due to the global COVID-19 pandemic. Previous research, including works by Afza and Nazir (2009), Arnold (2015), and Raheman and Nasr (2014), highlights the critical role of working capital in firm profitability. However, there exists a substantial gap in understanding how specific working capital policies—such as Aggressive Investment Policy (AIP) and Aggressive Financing Policy (AFP)—affect the financial performance of manufacturing firms in the Nigerian context, especially during periods of economic instability. Most existing studies focus on broader economic environments or other sectors, neglecting the unique challenges faced by manufacturing firms in Nigeria, a country with distinct economic pressures that influence working capital decisions.

Moreover, while some studies suggest that an aggressive working capital policy can yield higher profits (Onwumere et al., 2015), other studies caution about the risks associated with such approaches, particularly in volatile markets where liquidity is a key concern (Brigham & Houston, 2021). This inconsistency in the literature further underscores the need for a targeted investigation into how these policies operate in the Nigerian manufacturing sector,

especially in times of economic downturn. Thus, the core research problem this study seeks to address is the persistent inefficiency in working capital management among Nigerian manufacturing firms, which adversely affects their profitability and sustainability. Despite the critical role of working capital in firm operations, many companies continue to struggle with suboptimal policies, which exacerbate financial distress during periods of economic turbulence. This study, therefore, aims to fill the gap by empirically examining how Aggressive Investment Policies and Aggressive Financing Policies influence the financial performance of Nigerian manufacturing firms between 2019 and 2023.

Research Objective

The general objective of this study is to investigate the effect of working capital policies on the financial performance of Nigerian manufacturing companies from 2019 to 2023. The specific objectives are:

i. To determine the effect of Aggressive Investment Policy (AIP) on the financial performance of manufacturing companies in Nigeria.

ii. To examine the effect of Aggressive Financing Policy (AFP) on the financial performance of manufacturing companies in Nigeria.

Conceptual Clarification

Working capital policy represents a firm's strategic posture regarding the level and composition of current assets and the sources used to finance them. Unlike traditional working capital management, which emphasises operational efficiency of cash, inventory, receivables, and payables, working capital policy is inherently strategic, reflecting managerial risk appetite and long-term orientation toward liquidity–profitability trade-offs. Afza and Nazir (2009) conceptualise working capital policy as a continuum ranging from conservative to aggressive postures, with each stance implying different risk-return configurations.

Two dominant dimensions of working capital policy are particularly salient: investment policy and financing policy. Aggressive investment policy (AIP) is characterised by a relatively low proportion of current assets to total assets, signalling a deliberate compression of liquidity buffers in pursuit of higher returns. Conversely, conservative investment policy maintains higher current asset holdings to cushion operational uncertainties, albeit at the expense of potential profitability (Palombini and Nakamura, 2017). Aggressive financing policy (AFP), on the other hand, reflects greater reliance on short-term liabilities relative to total assets, premised on the cost advantage of short-term funds but accompanied by heightened refinancing and liquidity risks (Weinraub and Visscher, 2014).

Financial performance, within this study, is viewed not merely as accounting profitability but as an outcome of strategic resource deployment. Measures such as return on assets (ROA) and return on equity (ROE) capture managerial efficiency in transforming asset bases and shareholders' funds into earnings (Brigham and Houston, 2021). Conceptually, therefore, working capital policy becomes a strategic conduit through which firms translate short-term financial structure into long-term performance outcomes.

The critical conceptual proposition advanced in this study is that, during periods of economic downturn, such as 2019–2023 in Nigeria, the conventional risk–return logic of aggressive policies may be altered. Macroeconomic

volatility, high inflation, exchange rate depreciation, and constrained credit markets may weaken the profitability-enhancing potential of aggressive postures while amplifying their downside risks. Thus, the study departs from static conceptualisations and advances a context-sensitive view of working capital policy, arguing that its performance implications are contingent on macroeconomic conditions.

Theoretical Framework

This study is anchored primarily on the **Cash Conversion Cycle (CCC) theory** advanced by Gitman (1974) and refined by Richards and Laughlin (1980). The CCC conceptualises working capital as a dynamic process linking inventory acquisition, production, sales, and cash recovery. It posits that firms enhance profitability by shortening the time between cash outflows for inputs and cash inflows from sales. Empirical extensions of the CCC framework demonstrate that efficient management of receivables, inventories, and payables directly influences liquidity and profitability (Deloof, 2013). However, while the CCC framework explains operational efficiency, it does not explicitly address the strategic orientation underlying managerial choices about the level of current assets and liabilities. To bridge this gap, the study integrates insights from the **risk–return trade-off theory** in corporate finance, which posits that higher expected returns are associated with higher risk exposure (Brigham and Houston, 2021). Aggressive working capital policies embody this trade-off by compressing liquidity buffers in exchange for potentially higher profitability.

By synthesising CCC theory with risk–return logic, this study develops a **policy-oriented theoretical stance**: working capital policy influences financial performance by shaping the firm's exposure to liquidity risk and financing cost within the operational cycle. In stable environments, aggressive policies may enhance performance by lowering holding costs and financing expenses. In volatile environments, however, the same policies may undermine performance due to heightened refinancing risk and disrupted cash flows.

Empirical Review

Empirical evidence on working capital policy and firm performance remains mixed. Studies in Pakistan (Afza and Nazir, 2009) and Kenya (Nyabuti and Alala, 2014) document significant relationships between aggressive working capital policies and profitability, though the direction varies. While some report positive effects of aggressive investment postures on performance, others observe negative or insignificant impacts, suggesting that context matters.

Within Nigeria, Takon and Atseye (2015) and Ogundipe et al., (2015) establish that inefficient working capital management adversely affects profitability and market value. Onwumere et al., (2015) further demonstrate that aggressive investment policy positively influences profitability, whereas aggressive financing policy exhibits weaker and sometimes insignificant effects. These findings imply asymmetry between investment and financing dimensions of policy.

International studies also reveal contradictions. Alipour (2014) finds that shorter cash conversion cycles improve profitability, whereas Zawaira and Mutenheri (2014) report no significant association between several working capital indicators and firm performance in Zimbabwe. Such inconsistencies suggest that institutional environment, macroeconomic

stability, and sectoral structure mediate outcomes.

Two major gaps emerge from this body of literature. First, most Nigerian studies emphasise working capital management components rather than explicit working capital policies. Second, limited attention is given to periods of macroeconomic distress, when liquidity constraints and financing risks are most pronounced.

This study responds to these gaps by isolating aggressive investment and aggressive financing policies and examining their effects on manufacturing firms' financial performance during Nigeria's 2019–2023 economic downturn. In doing so, it contributes a context-specific, policy-focused, and theoretically integrated perspective to the working capital discourse.

3. Methodology

This study employed a correlational research design to investigate the relationship between working capital policies and financial performance. The analysis utilized panel data from ten manufacturing companies listed on the Nigerian Stock Exchange (NSE) over the period 2019 to 2023. The sample, selected via simple random sampling from a population of 52 listed manufacturing firms, included Dangote Cement Plc, Cadbury Nigeria Plc, Guinness Nigeria Plc, Honeywell Flour Mill, Lafarge Africa Plc, Nestlé Nigeria Plc, Unilever Nigeria Plc, Vitafoam Nigeria Plc, UACN Plc, and Flour Mills Nigeria Plc.

Secondary data were sourced from the audited annual reports of the sampled firms and the Nigerian Exchange Group Factbook. The choice of secondary data aligns with the study's policy-oriented focus and permits objective measurement of both working capital policy indicators and financial performance. The variables for the study were operationalized as follows:

Dependent Variables: Financial Performance, proxied by Return on Assets (ROA), Return on Equity (ROE), and Tobin's Q.

Independent Variables: Working Capital Policies, measured as: Aggressive Investment Policy (AIP): Ratio of current assets to total assets. A lower ratio indicates a more aggressive policy.

Aggressive Financing Policy (AFP): Ratio of current liabilities to total assets. A higher ratio indicates a more aggressive policy.

Control Variable: Firm Size (FSIZE), measured as the natural logarithm of total assets.

To assess the relationships, the following panel regression models were specified:

ROA Model:
$ROA\ it = \alpha + \beta 1AIPit + \beta 2AFPit + \beta 3FSIZEit + \varepsilon it$

ROE Model:
$ROE\ it = \alpha + \beta 1AIPit + \beta 2AFPit + \beta 3FSIZEit + \varepsilon it$

Tobin's Q Model:
$Tobin's\ Qit = \alpha + \beta 1AIPit + \beta 2AFPit + \beta 3FSIZEit + \varepsilon it$

Where *i* denotes the firm, *t* denotes the year, α is the constant, β1-β3 are the coefficients, and ε is the error term.

The data analysis involved descriptive statistics, correlation analysis to check for multicollinearity, and panel regression analysis. The Hausman specification test was conducted to determine the appropriate estimation model between fixed effects and random effects. All

analyses were performed using E-Views software.

4. Data Analysis, Findings, and Discussion

Descriptive Statistics and Correlation Analysis

Table 1 presents the descriptive statistics for the study variables. The mean values for Aggressive Financing Policy (AFP) and Aggressive Investment Policy (AIP) are 0.351 and 0.351 respectively, indicating the sample firms' average stance on working capital policies. The performance variables show a mean ROA of 0.181 and ROE of 0.424, with Tobin's Q exhibiting a high mean value of 1490.98, reflecting substantial market valuation relative to asset value.

Table 1: Descriptive Statistics (2019–2023)

Variable	Mean	Median	Maximum	Minimum	Std. Dev.
AFP	0.351	0.325	0.686	0.144	0.155
AIP	0.351	0.353	0.547	0.122	0.103
FSIZE	7.933	7.894	8.984	7.313	0.503
ROA	0.181	0.193	0.299	0.053	0.065
ROE	0.424	0.402	0.848	0.135	0.174
Tobin's Q	1490.98	1464.76	3538.01	101.84	923.44

Source:Authors'computation(2025)

The correlation matrix (Table 2) reveals that the independent variables are not highly correlated, with all coefficients below 0.8, thus indicating the absence of severe multicollinearity that could bias the regression results (Gujarati & Porter, 2009).

Table 2: Correlation Matrix of Independent Variables

Variable	AFP	AIP	FSIZE
AFP	1		
AIP	0.473	1	
FSIZE	-0.359	0.533	1

Source: Authors' computation (2025)

Regression Results and Hypothesis Testing

The Hausman test results for all models indicated that the null hypothesis could not be rejected, justifying the use of the random effects model for estimation.

Effect on Return on Equity (ROE) The regression results for ROE are presented in Table 3. Aggressive Financing Policy (AFP) shows a positive and statistically significant coefficient (β = 0.457, p = 0.0289). This implies that a unit increase in the aggressiveness of a firm's financing policy is associated with a 45.7% increase in ROE, holding other factors constant. Conversely, Aggressive Investment Policy (AIP) has a significant negative effect on ROE (β = -0.771, p = 0.0005). Firm size was not statistically significant. The model explains approximately 21.8% of the variation in ROE (R^2 = 0.218).

Table 3: Random Effects Regression Results for ROE

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Constant	1.145	0.921	1.243	0.225
AFP	0.457	0.198	2.313	0.029**
AIP	-0.771	0.194	-3.972	0.000***
FSIZE	-0.08	0.104	-0.766	0.451
R-squared	0.218		F-statistic	2.422 (0.080)
Adjusted R-squared	0.128		Durbin-Watson	1.88

*Note: ***, ** denote significance at the 1% and 5% levels, respectively.*

Source: Authors' computation (2025)

Effect on Return on Assets (ROA) As shown in Table 4, the results for ROA reveal that Aggressive Investment Policy (AIP) maintains a significant negative relationship (β = -0.370, p = 0.0000). However, Aggressive Financing Policy (AFP) has an insignificant negative effect on ROA (β = -0.104, p = 0.3475). This model has a higher explanatory power, with an R^2 of 0.341.

Table 4: Random Effects Regression Results for ROA

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Constant	0.537	0.427	1.26	0.219
AFP	-0.104	0.109	-0.957	0.348
AIP	-0.37	0.037	-9.891	0.000***
FSIZE	-0.025	0.049	-0.52	0.608
R-squared	0.341		F-statistic	4.475 (0.011)
Adjusted R-squared	0.264		Durbin-Watson	2.413

*Note: *** denotes significance at the 1% level.*

Source: Authors' computation (2025)

Effect on Tobin's Q

Table 5 presents the results for Tobin's Q. Aggressive Financing Policy (AFP) exhibits a strong positive and significant effect (β = 3.929, p = 0.0014), indicating that a more aggressive financing strategy is associated with a higher market valuation. Aggressive Investment Policy (AIP) shows a negative and marginally significant effect (β = -0.996, p = 0.0696). This model explains 46.6% of the variation in Tobin's Q.

Table 5: Random Effects Regression Results for Tobin's Q

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Constant	3.773	3.476	1.085	0.289
AFP	3.929	1.091	3.601	0.001***
AIP	-0.996	0.524	-1.899	0.070*
FSIZE	0.278	0.372	0.748	0.462
R-squared	0.466		F-statistic	4.195 (0.007)
Adjusted R-squared	0.355		Durbin-Watson	1.803

Source: Authors' computation (2025)

Hypothesis Testing

Hypothesis One ($H0_1$): Aggressive Investment Policy has no significant effect on financial performance.
The results consistently show a significant negative effect of AIP on ROA and ROE. Therefore, the null hypothesis is rejected. Aggressive Investment Policy has a significant adverse effect on the profitability of Nigerian manufacturing firms.

Hypothesis Two ($H0_2$): Aggressive Financing Policy has no significant effect on financial performance.
The results show a significant positive effect of AFP on ROE and Tobin's Q. Therefore, the null hypothesis is rejected. Aggressive Financing Policy has a significant positive effect on the profitability and market value of the firms.

Discussion of Findings

The study set out to determine whether aggressive working capital policies significantly shape the financial performance of Nigerian manufacturing firms during a period of pronounced macroeconomic stress. The findings show that the effects of aggressive working capital policy are neither uniformly positive nor uniformly negative but depend on the specific policy dimension and the prevailing economic conditions. This directly addresses the research problem by questioning the suitability of aggressive postures in an environment characterised by liquidity constraints, high financing costs and volatile cashflows.

Concerning Aggressive Investment Policy (AIP), the significant negative impact of an aggressive investment policy on both ROA and ROE indicates that minimizing investment in current assets may be detrimental in the Nigerian manufacturing context. However, the direction of this effect indicates that reducing the proportion of current assets relative to total assets does not automatically improve performance in the Nigerian manufacturing sector during the period under review. This outcome challenges the conventional risk–return proposition that lower liquidity buffers enhance profitability through reduced holding costs and better asset utilisation (Brigham and Houston, 2021). Instead, the evidence suggests that current assets function as strategic buffers that support production continuity and payment capacity in volatile environments. This finding is consistent with studies reporting a negative association between excessive reductions in working capital and profitability (Raheman &Nasr, 2014; Padachi, 2016) but contrasts with earlier Nigerian evidence of a positive effect (Onwumere et al., 2015), highlighting the importance of temporal and economic context.

The finding that an aggressive financing policy enhances ROE and Tobin's Q aligns with the theoretical expectation that using lower-cost short-term debt can boost returns on equity and signal operational efficiency to the market, thereby increasing firm value. Although short-term financing may appear cheaper, its refinancing risk and sensitivity to interest rate fluctuations may offset any cost advantages. This challenges the traditional view that aggressive financing policies improve performance through lower financing costs (Weinraub and Visscher, 2014) and aligns with evidence from Afza and Nazir (2009) and Zawaira and Mutenheri (2014), though it differs from Nyabuti and Alala (2014).

The insignificant effect of firm size on performance challenges the conventional wisdom that larger firms are inherently more efficient. This may be specific to the studied period and sector, where the scale of operations did not confer a significant advantage in navigating the unique economic challenges.

Theoretically, the study integrates risk–return logic with CCC theory to show that profitability outcomes depend on both internal efficiency and external macroeconomic conditions. Empirically, it contributes Nigerian evidence that emphasises policy dimensions and downturn conditions, reinforcing the argument that sustainable performance is better supported by balanced and flexible working capital policies than by rigidly aggressive postures.

Conclusion

This study provides empirical evidence on the nuanced impact of working capital policies on the financial performance of Nigerian manufacturing firms during a significant economic downturn. The study concludes that aggressive working capital policies do not inherently guarantee superior financial performance for Nigerian manufacturing firms, especially during periods of macroeconomic stress. Rather than serving as universal best practices, aggressive investment and financing postures operate as context-dependent strategic choices whose effectiveness is shaped by prevailing economic conditions. Conceptually, the findings reposition working capital policy from a static liquidity–profitability trade-off toward a dynamic resilience-oriented framework in which current assets function as strategic buffers rather than idle resources. Theoretically, the study extends the Cash Conversion Cycle (CCC) framework by integrating risk–return logic and demonstrating that the profitability implications of working capital policy are conditioned by macroeconomic volatility, not merely by internal efficiency. Empirically, the findings align with studies reporting negative or insignificant effects of aggressive policies on profitability (Afza and Nazir, 2009; Raheman and Nasr, 2014; Padachi, 2016; Zawaira and Mutenheri, 2014), while diverging from earlier evidence that documented positive effects (Onwumere, Ibe, and Ugbam, 2015; Nyabuti and Alala, 2014). Overall, the study establishes that policy aggressiveness may signal vulnerability rather than strength in unstable economic environments.

Recommendations

Manufacturing firms should adopt balanced and flexible working capital policies that prioritise both profitability and liquidity preservation, rather than rigidly aggressive postures. Managers are advised to integrate macroeconomic indicators such as inflation, exchange rate movements, and interest rate trends into working capital planning in order to adjust policies dynamically. Policymakers should enhance access to stable and affordable long-term financing to reduce firms' reliance on risky short-term debt. Investors and analysts should interpret aggressive working capital ratios with caution, recognising that high aggressiveness does not necessarily imply superior performance. Future research should explore other policy orientations, longer time horizons, and cross-country contexts to further deepen understanding of the context-sensitive nature of working capital policy outcomes.

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