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How does working capital management affect the profitability of Spanish SMEs?

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Abstract

This paper analyzes the relation between working capital management and profitability for small and medium-sized enterprises (SMEs) by controlling for unobservable heterogeneity and possible endogeneity. Unlike previous studies, we examine a non-linear relation between these two variables. Our results show that there is a non-monotonic (concave) relationship between working capital level and firm profitability, which indicates that SMEs have an optimal working capital level that maximizes their profitability. In addition, a robustness check of our results confirms that firms' profitability decreases as they move away from their optimal level.

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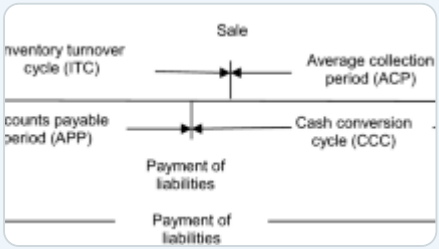

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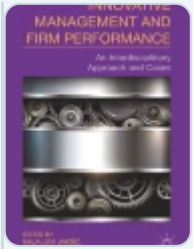

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Notes

1. European Payment Index is a report based on an annual written survey carried out by *Intrum Justia* in 25 European countries and involves several thousand companies.

2. This is a necessary condition to have a sufficient number of periods to be able to test for second-order serial correlation. A t-statistic on the difference of

means indicates that this criterion for retaining data does not affect the mean values of the variables used in our study.

3. The inclusion in the model of the cost of financing as independent variable does not alter these results.

4. Like Deloof (2003), we find that Cash Conversion Cycle does not affect firms' profitability when we estimate a linear relationship.

5. In particular, we divided our sample according to mean size and age. Then, we estimated the model for both firms above and below the mean values. We also estimated the model for firms above the 90th percentile in order to check whether we obtain similar results for larger and older firms. The results show that there is also a concave relationship for these sub-samples.

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Appendix

See Table 7.

Table 7 Mean and median values of firms' characteristic by size and sector

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