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THE IMPACT OF SOLVENCY AND WORKING CAPITAL ON PROFITABILITY

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Abstract - *Every business requires working capital for its survival. A solvent company has assets that exceed its liabilities sufficiently to reinvest in its growth. Solvency refers to company's ability to fulfil its obligations. Assessment of a company's ability to pay it obligations such as to make interest and principal payments generally include analysis of the components of its financial structure. The degree of solvency in a business is measured by the relationship between the assets, liabilities and equity of a business at a given point in time. The company should determine the appropriate solvency levels in increasing profitability. The purpose of this research is to know whether solvency and working capital have an impact on profitability at CV Masindo Electric Medan. The research design used in this research is a descriptive research design with conducting financial statement analysis. Research methods used are descriptive statistic analysis with financial ratio analysis, coefficient correlation, coefficient of determination, linear regression analysis, t test and F test.This research concludes that solvency and working capital have impact on profitability at CV Masindo Electric Medan. Based on T-test, the value of Tcount is higher than Ttable. Therefore, the solvency and working capital have a significant impact on profitability at CV Masindo Electric Medan partially. Based on the F test, the value of Fcount is higher than Ftable.*

Therefore, the solvency and working capital have a significant impact on profitability at CV Masindo Electric Medan simultaneously. The profitability can be explained by working capital and solvency in 99.8%, while the remaining in 0.2% is explained by other factors. Based on the working capital analysis, there is decrease in working capital in the year 2012-2016. It shows that the company doesn't conduct working capital management appropriately. Based on solvency analysis, there is increasing insolvency in the year 2012-2016. The company has limitations from internal fund from profit and capital from the owner. Therefore, the company finds a way to conducting business with external funds such as from account payable andbank loan. Based on profitability analysis, it can be known that there is decreasing of profitability in year 2012-2016. The company cannot increase the sales price to a high level because there is low-profit margin.

Keywords: Solvency, Working Capital and Profitability

1. INTRODUCTION

The main objective of any company is to maximize its profit. A company that does not make profit cannot survive in business for a long time. In other words, effective and efficient management to obtain profitability are very important for company's survival. Maximising shareholders wealth is only possible if the company makes adequate profits to be distributed out as dividends. One of the management's task is to conduct financial management which will assure that managers will make decisions that will increase shareholders' wealth. Therefore, proper planning must be done to mitigate the risks that may affect the profits or prevent the achievement of this goal. Companies focus on profitability because it plays a critical role in evaluating the current financial health and stability of a company and achieving high performance and growth in the future. Profitability requires that income derived from the company's business activities exceeds the company's expenses

Profitability depends on the working capital because an inefficient working capital management might lead to lack of profitability and tend to the financial crisis. Every business requires working capital for its survival. Working capital is a vital part of business investment which is essential forcontinuous business operations. Working capital management is an important company's financial decision since it directly affects the profitability of the company. The important part of managing working capital is maintaining the required liquidity in day-to-day operation to ensure the company's smooth running and meet its obligations. Working capital is a positive asset. It can be used toincrease sales by giving customers favourable credit terms, preventing lack of inventory by keeping sufficient levels of safety stock, and ensuring the reliabilityof deliveries by paying suppliers on time. A greater amount of working capital also improves some financial indicators such as the current ratio. A sufficient level of cash is also inevitable to be able to cope with day to day payments. The basic purpose of managing working capital is to control the current financial resources of a firm so that a balance is created between profitability of the firm and risk associated with that profitability. A solvent company has assets that exceed its liabilities sufficiently to reinvestment in its growth.

Solvency refers to a company's ability to fulfill its obligations. Assessment of a company's ability to pay it obligations such as to make interest and principal payments generally includes analysis of the components of its financial structure. Solvency ratios provide information regarding the relative amount of debt in the company's capital structure and adequacy of earnings and cash flow to cover interest expenses and other fixed charges as they come due. A company is considered solvent if the existing assets exceed or equal total liabilities. If total assets are lower than current liabilities, the firm faces an insolvency risk and cannot pay its debts. Solvency impacts a company's ability to obtain loans, financing and investment capital. This is because solvency indicates a company's current and long-term financial health and stability as determined by assets ratio to liabilities. In other words, the degree of solvency in a business is measured by the relationship between the assets, liabilities, and equity of a business at a given point in time. A company may be able to cover current or upcoming liabilities by quickly liquidating assets. The company should determine the appropriate solvency levels in increasing profitability.

According to Narayan & Sriananthakumar (2020), Solvency and working capital have a significant impact on profitability. Working capital management is an essential component of corporate finance management since it directly influences the firm's profitability. In any business organization, it is obvious that there must be sufficient working capital to run day-to-day operations. Therefore, working capital of firm's must be sufficient to operate the business activities smoothly. Then, the concern of working capital management is setting sufficient (optimal level) of working capital and managing short term assets and liabilities of firms within a specified period of time,

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usually one year. Business capability relies on its ability to manage receivables, inventories and payables effectively. Solvency refers to thecompanies continuous ability to meet maturing obligations. To ensure solvency, the company should be very liquid which means larger current assets holding. Suppose a company maintains a relatively large investment in current assets. In that case, it will have no difficulties in paying claims of creditors when they become due and will be able to fulfill customer demand and ensure sufficient purchase. This research is done at CV Masindo Electric Medan that is engaged in the distributor of the electrical component. The company has goals in increasing the business size and activities. Therefore, the company should generate sufficent profit so that there is sufficient funds for developing the business in the future. The working capital, solvency and profitability of the company in the year 2012-2016 can be seen as follows:

Table 1
Working Capital, Solvency and Profitability of The Company in Year 2012-2016

Year	Current Ratio	Debt to Equity Ratio	Return on Asset
2012	3.81	381.15%	1.61%
2013	2.79	279.72%	1.13%
2014	2.71	271.78%	1.05%
2015	2.66	266.06%	0.96%
2016	2.65	265.90%	0.88%

Source : CV Masindo Electric Medan (2017)

Based on the table above, there is decreasing in profitability in the year 2012-2016. It shows that the company cannot increase its profitability. The fund from profit is needed to conducting the business in the future. The insufficient fund can obstacle the company in making a business decision such as an investment decision. Many factors have an impact on decreasing profitability, such as working capital and solvency. The company doesn't conduct effective working capital management. After all, the company cannot increase profitability because the company cannot use current assets to increase sales. It can be known that the company want to increase profit by increasing purchasing of inventory and giving account receivable. Therefore, it can reduce the amount of cash that is needed for the company's business activities. There are increasing short-term liabilities for financing the operational activities because the company cannot increase sales in raising internal funds. The company cannot convert the current asset to cash quickly because it will increase its liabilities for operational activities. Some existing assets aren't productive in generating sales, such as inventory that cannot be sold quickly and uncollected accounts receivable. The company makes increasing of liabilities because there is a lack of fund from sales activities. There is increasing account payable and short-term bank loan as the fund for purchasing inventory and paying the company's expense. The company also makes purchasing of equipment with long term liabilities from bank loans. The increasing of liabilities can cause problem in company's solvency in paying liabilities. A problem that can be identified in this research is as follows: Do the solvency and working capital have impact on profitability at CV Masindo Electric Medan? This study aims to know whether solvency and working capital have impact on profitability at CV Masindo Electric Medan.

2. LITERATURE REVIEW

According to Tesone (2015), management is the accomplishment of an organization's objectives through the activities of others. According to Murugesan (2015), management is a distinct process, consisting of planning, organizing, actuating and controlling, performed to determine and accomplish stated goals by the use of human beings and other resources. According to Plunkett (2015), management is one or more managers individually or collectively setting and achieving goals by exercising related functions (planning, organizing, staffing, leading and controlling) and coordinating various resources (information, materials, money and people)". According to Petty (2015) financial management is the study of how people and businesses evaluate investments and raise funds of finance them. According to Babu, (2015), financial management is concerned with the efficient use of an important economic resources namely capital fund. According to Bose (2015) financial management refers to that part of managerial activity which is concerned with procurement and utilisation of funds for business purposes".

Financial management involves the application of general management principles to a particular financial operation. Financial management is concerned with the efficient use of capital funds. It evaluates how funds are used and procured. In all cases, financial management involves a sound judgement, combined with a logical approach to decision making. These alternatives have to be evaluated on the basis of some analytical framework and commercial strategies of an enterprise. According to Mathur (2015), financial management functions are as follows: investment decisions, financing decisions.

According to Rao (2013), a financial statement collects facts and figures organized according to systematic accounting procedures. According to Palepu (2013), a firm's financial statements summarize the economic consequences of its business activities. According to Warren (2015), the accounting reports providing this information are called financial statements.

Financial statements are the primary means of communicating accounting information about a business to those who have an interest in the business. These statements model the business enterprise in financial terms. Financial statement is a written report which quantitatively describes the financial health of a company. financial statement is report that provide information about company's financial position prepared in detail and complete include balance sheet, income statement and so forth. After transactions have been recorded and summarized, reports are prepared for users. The accounting reports providing this information are called financial statements. Financial statements are a useful tool in analyzing company's financial position and performance. Financial statements are issued for many purposes such as for investors, tax authorities, or other significant partners who require financial information. Financial statements are normally produced on an annual basis. To ensure comparability and consistency, financial statements areusually based on financial accounting standards. According to Horne (2015),, financial (statement) analysis is the art of transforming data from financial statements into information useful for informeddecision-makingg. Financial analysis involves the use of various financialstatements". According to Goel (2015), financial statement analysis is defined as the process of identifying financial strengths and weaknesses of thefirm by properly establishing the relationship between the items of the financial statements". According to Stice (2015) financial statement analysis is the examination of both the relationships among financial statement numbers and the trends in those numbers over time.

One purpose of financial statement analysis is to use the past performance ofa company to predict its future profitability and cash flows. Financial statementanalysis is an integrated process that informs decision making and should if applied correctly optimally support the viability of a business. It is effective tool used for assessing the integrity of capital investment decisions and effective and efficient management of existing physical assets. It ensures that the best value of money is achieved and that resources are allocated in a manner that reflects the business growth. The financial analysis aims to diagnose the information content in financial statements to judge the firm's profitability, financial soundness and chalk out the way to improve existing performance. According to Dyson (2015), types of financial statement analysis are as follows: horizontal analysis, trend analysis, vertical analysis, ratio analysis. According to Azis (2017), solvency refers to the company's ability to meet its obligations concerning debt. According to Wild (2015), solvency refers to a company's long-run financial viability and its ability to cover deficits. According to Warren (2015), solvency is the ability of a firm to pay its debts as they come due.

Solvency reflects the company's ability to repay obligations, including principal payments and its benefits. Solvency ratios convey a company's ability to meet the payment schedules of its obligations. Solvency ratio measures the company's ability to pay its debts from the profits it is generating. The solvency ratio tells what part of the total liabilities the company can pay from equity. The ratio is very important, because it does not rely on existing reserves but focuses on the company's ability to generate cash flow from what to pay back the loans. Solvency is the ability to pay off all debts if the business are liquidated. Solvency ratios show the relationship of the total assets, the total liabilities, and the net worth. According to Chandra (2015), measurement of solvency are as follows: debt to equity ratio, debt to asset ratio,

According to Angahar (2014), working capital refers to the firm's current assets and current liabilities required to be combined with fixed assets for day-to-day business activities. According to Block (2015), working capital management involves the financing and management of the firm's current assets. According to Vemimmen (2015), working capital is defined as existing assets minus current liabilities

Working capital mainly represents the current assets, which is the portion of a business that changes from one type of resources to another during the day-to-day business execution. Current assets mainly comprise cash, prepaid expenses, short-term investments, accounts receivable, inventory, and other current assets. Networking capital can be measured by deducting the current liabilities of a firm from its current assets. If current assets' value is less than current liabilities, then networking capital would have a negative value showing a deficit working capital. When a business entity makes decisions regarding its current assets and current liabilities, it can be termed working capital management. Working capital management can be defined as an accounting approach that emphasises maintaining proper levels of existing assets and current liabilities. It provides enough cash to meet the short-term obligations of a firm. According to Chandra (2015), factors influencing working capitalrequirements are as follows: nature of business, seasonality of operation, production policy, market conditions, conditions of supply. According to Gopal (2015), factors that influencing working capital are as follows: nature or character of business, size of business/scale of operations, sales and demand conditions, technology and manufacturing policy, credit policy, availability of credit, operating efficiency, seasonal business, variable of production competencies, business cycles, price level changes, working capital cycle. According to Paramasivan (2015), the importance of working capital are as follows: purchase of raw materials and spares, payment of wages and salary, day to day expenses, provide credit obligations. According to Sagner (2015), risk in working capital are as follows: operational risk, credit risk, liquidity risk, information reporting risk, According to Brealey (2015), element of working capital are asfollows: current asset, current liabilities, According to Horne (2015), measurement of working capital ratio areas follows: current ratio, working capital turnover. According to Angahar (2014), profitability can create an excess of revenue over expenses to attract and hold investment capital. According to Azis (2017), profitability refers to the company's ability to generate profits as a return on the funds invested. According to Libby (2013), profitability is a primary measure of the overall success of a company. Indeed, it is necessary for a company's survival". According to Foersteer (2015), the measurement of profitability are asfollows: return on equity, return on asset,

According to Waran (2017), there is the relationship between solvency and working capital with profitabilitity. Company that has low liquidity of working capital, facing high risk results to high profitability. The issue here is in managing working capital, firm must consider all the items in both accounts and try to balance the risk and return. The sustainability of the corporation typically depends on the management of working capital of a firm. Working capital management efficiency is vital especially for manufacturing firms, where a major part of assets is composed of current assets. Working capital management is very important to create value for the shareholders. The profitability of a firm depends on the efficient management of working capital. Solvency ratio has negative and highly significant impact on profitability. It means that the debt to equity ratio increases, then performance decreases. A higher level of debt in a company's capital structure increases the risk of default and results in higher borrowing costs for the company to compensate lenders. According to Rahman (2015), there is positive impact of working capital management on profitability. Working capital is essential components of total capital for any business organization to operate its daily activities. Working capital involves with total current assets like accounts receivable, marketable securities, cash, inventory, and prepaid expenses. The profitability and productivity of companies depend on efficient use of current asset of those companies. Every organization requires efficient working capital management to minimize the short-term cost of capital and maximise productivity that affects companies' profitability. Working capital management is one of the most important areas while making the liquidity and profitability comparisons among the company involving the decision of the amount and composition of current asset and the financing of these assets. It directly affects the profitability of firms. Companies' inventory management policy, debtor's management policy and creditors' management policy have an important role in its profitability performance of the corporation.

According to Waran (2017) Indian Pharmaceutical Industry has played a key role in promoting and sustaining development in the vital field of medicines. It ranks very high in the third world, in terms of technology, quality and range of medicines manufactured. Liquidity or Solvency management is very important for every organization it analyzed on the basis of short term and long term solvency or liquidity. The objective of the study is to find out the impact of solvency and working capital on profitability of select multinational pharmaceutical companies in India. The period of the study is from 2000-01 to 2014-15. Secondary data is used for the study. The data analysis was done using Ratio analysis and statistical tools like mean, standard deviation, coefficient of variation, compound annual

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growth rate and multiple regression. The regression analysis results point out that the GlaxoSmithKline laboratories, Lupin, Sun Pharma and Cipla Pharma significantly influenced profitability ratios of Net Profit, Return on Assets and Return on Capital Employed. Abbott Pharma, Biocon, Pfizer, Ranbaxy, Dr. Reddy's, and Aurobindo Pharma have not significantly influenced profitability ratios. Hence these pharmaceutical companies should pay more attention to improve Net Profit, Return on Assets, and Return on Capital employed. According to Singh (2015), a well designed and implemented working capital management has a significant contribution for firms' profitability and maintains liquidity powers. The purpose of this study is to assess working capital adequacy and its impact on profitability; to investigate the relationship between profitability and liquidity of firms. Natural logarithm of total current liabilities and Relative Solvency Ratio (RSR) are taken as dependent variables to measure the required size of current liabilities and firm's solvency level respectively. Independent variables are sales, return on assets, current ratio, and cash conversion cycles. These are included in the panel data regression to assess for 250 firms for the period of 10 years. The regression result indicated that sales and cash conversion cycle have highly positive significant effect to determine required current liabilities (short term debt) whereas return on assets and current ratio have highly negative significant effect to determine required current liabilities. The result of negative association between profitability and liquidity is statistically insignificant. With the help of student t- test, the study also revealed that firms with adequate working capital achieved better performance than firms with less working capital related to their operational sizes. Therefore, the null hypothesis that there is no difference between firms which have adequate working capital and less working capital in relation to their operational size on profitability is rejected as the p value is less than 0.05.

According to Angahar (2014), This study empirically examined the impact of working capital management (Measured by: the number of days accounts receivable are outstanding-DAR, the number of days inventory are held- DINV, and the cash conversion cycle- CCC), on profitability (measured by return on assets-ROA) of Nigerian Cement Industry for a period of eight (8) years (2002-2009). Data from a sample of four

(4) out of the five (5) cement companies quoted on the Nigerian Stock Exchange (NSE) were analyzed using descriptive statistics and multiple regression analysis. The study found an insignificant negative relationship between the profitability (measured by ROA) of cement companies quoted on the NSE and the number of days accounts receivable are outstanding (DAR). The study also found a significant negative relationship between the profitability of these cement companies and the number of days inventory are held (DINV). The study finally revealed a significant positive relationship between the profitability and the cash conversion cycle (CCC). The study concludes that the profitability of cement companies quoted on the NSE during the study period is influenced by DINV and CCC. Therefore, the study recommends that managers of these cement companies manage their working capital in more efficient ways by reducing the number of days inventory are held to an optimal level to enhance their profitability and create value for their shareholders. Managers of Nigerian cement companies should also improve their cash flows by reducing their cash conversion cycle. Study Azis (2017) thi study aim to examine the relationship between solvency ratios and profitability ratios. The study was conducted on the industrial food companies listed in Amman Bursa from 2012 to 2014. The results revealed no relationship between the following solvency ratios (debt/asset ratio, debt/equity ratio, long-term debt/assets ratio, long-term debt/equity ratio, and interest coverage) and the following profitability ratios (gross profit margin and operating cash flow margin). The results show a negative relationship between both ratios of solvency (debt/asset ratio, debt/equity ratio) and the following profitability ratios

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(operating profit margin, net profit margin, and return on assets. There are no relationship ratios (long term debt ratios/assets), long term debt ratios/equity, and interest coverage, and the following profitability ratios. Study Juliana et al. (2020) identified that culture, income, and risk have a direct relationship between them for buying financial assets.

According to Meleis (2012), a theoretical framework is a conceptual system or framework invented for research purpose. The theoretical framework of this research can be presented in the figure below:

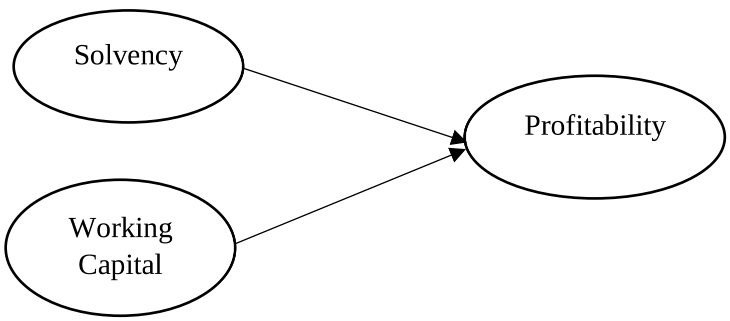

Figure 1 . Theoretical Framework

3. RESEARCH METHOD

According to Kotzab (2012), the research design will typically include how data is to be collected, what instruments will be employed, how the instruments will be used and the intended means for analyzing data collected. According to Brink (2015) and Purwanto et al.(2021), descriptive research is research that try to describe a phenomenon, result, and events that occur in the present. Descriptive research focuses on solving actual problems at the time of the research conducted.

According to Kotzab (2012), the correlation method is a method used to know the relationship between the variable in the research and analyse how the variable can influence the other variable. The existence of the relationship and the level of this variable is important because by knowing the level of existing relationships, the writer will be able to develop it according to the purpose of the research. Therefore, this type of research usually involves a statistical measure in a level relationship called correlation.

The operational variables consist of:

1. Variable X: this is an independent variable that influences the dependentvariable. The independent variable is solvency and working capital
2. Variable Y: this is the dependent variable. In doing research this is the primary thing that interested me. The dependent variable is profitability.

The definition of operational variables can be seen in the table below:

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Table 2 Definition of Operational Variables

Variable	Measurement	Scale
Solvency (X_1)	Debt to Equity Ratio	Ratio
Working Capital (X_2)	Current Ratio	Ratio
Profitability (Y)	Return on Asset	Ratio

The data collection methods in this research are as follows primary data and secondary data. The data analysis method are descriptive analysis, coefficient of correlation, multiple regression analysis, and F-Test, t-Test, coefficient of determination

4. RESULT AND DISCUSSION

Financial statements are prepared to inform people about the company's financial situation. Financial statements are the output of the accounting process, a formal way of communicating financial information that can be used by a variety of parties in making decisions about a business. The owners of an existing business use information derived from financial statements in planning and evaluating business activities. Financial statements are a critical source of information for most business decisions. Financial statements are prepared to present a periodical review or report on progress by the management and deal with the status of investment in the business and results achieved during the certain period.

The balance sheet reflects a company's financial position. The balance sheet lists the company's assets, liabilities, and stockholders' equity as of a specific moment in time. Financial condition is communicated in an accounting report called the balance sheet. The balance sheet presents the assets, liabilities, and residual equity of the owner or owners of a business. It is a snapshot of the business, showing its financial position at a specific point in time. That specific moment is on the date of the balance sheet. Thus, it captures the financial position of a company at a particular point in time. The balance sheet is one of the most important statements in a company's accounts. It shows what assets and liabilitiesa company has and how shareholders and debt fund it. The balance sheet provides information that is useful when assessing the financial stability of a company. A balance sheet is a statement drawn up at a particular point in time, of the values of assets owned and of liabilities outstanding. The balancing item is called equity. A balance sheet is a systematized statement in financial terms of the resources and sources of these resources at a specified date. A report of the financial position of a firm at a given date. It shows the type and value of sources from which funds have been derived and the various ways in which these funds have been invested and applied. The company's balance sheetin the year 2012-2016 are as follows:

Table 3 Balance Sheet of CV Masindo Electric Medan Year 2012-2016

Description	2012	2013	2014	2015	2016
Asset					

Current Asset	28,382,253,836	30,485,939,956	32,682,128,774	35,014,245,075	36,934,722,951
Fixed Asset	11,620,162,226	15,910,052,861	15,542,466,483	16,908,897,173	17,627,427,344
Total Asset	40,002,416,062	46,395,992,817	48,224,595,257	51,923,142,248	54,562,150,295
Liabilities and Equity					
Current Liabilities	7,446,528,237	10,898,640,081	12,025,010,864	13,160,290,087	13,890,567,287
Non Current Liabilities	7,521,896,388	9,938,095,405	10,134,794,960	12,199,102,239	13,627,746,599
Total Liabilities	14,968,424,625	20,836,735,486	22,159,805,824	25,359,392,326	27,518,313,886
Equity	25,033,991,437	25,559,257,331	26,064,789,433	26,563,749,922	27,043,836,409
Total Liabilities and Equity	40,002,416,062	46,395,992,817	48,224,595,257	51,923,142,248	54,562,150,295

Source : CV Masindo Electric Medan (2018)

The income statement reports the profitability of a business for a stated period of time. In accounting, the company measures profitability for a period such as a year by comparing the revenues earned with the expenses incurred to generate these revenues. Revenues are the inflows of assets such as cash resulting from the sale of products or the rendering of services to customers. Expenses are the costs incurred to create revenues. Expenses are measured by the assets consumed. If the revenues of a period exceed the expenses of the same period, it can obtain net income. The income statement presents the revenues and expenses of the business over some time. The income statement shows the results of the business's primary operating activities, which provide the production and sale of goods. The income statement also computes the net income or profit forthe period. Revenues are the resources that flow into the business primarily from the selling of goods. Expenses are the costs associated with generating revenues. As a result of the sales product, the business earned a profit. Profit activities are presented in an accounting report called the income statement. The income statement of the

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company in the year 2012-2016 are as follows:

Table 4. Income Statement of CV Masindo Electric Medan Year 2012-2016

Description	2012	2013	2014	2015	2016
Sales	51,157,786,256	52,281,837,946	52,769,838,581	53,478,272,929	55,184,266,445
Cost of Goods Sold	47,332,036,487	48,456,835,642	48,707,664,573	48,933,838,481	49,566,917,407
Gross Profit	3,825,749,769	3,825,002,304	4,062,174,008	4,544,434,448	5,617,349,038
Operational Expense	2,933,462,206	3,041,842,327	3,352,695,818	3,829,988,230	4,880,867,182
Operational Profit	892,287,563	783,159,977	709,478,190	714,446,218	736,481,856
Other Income	8,170,384	8,855,534	9,480,413	9,599,161	10,899,220
Net Income Before Tax	900,457,947	792,015,511	718,958,603	724,045,379	747,381,076
Income Tax	257,478,530	266,749,617	213,426,501	225,084,890	267,294,589
Net Income After Tax	642,979,417	525,265,894	505,532,102	498,960,489	480,086,487

Source : CV Masindo Electric Medan (2018)

Corporate financial management primarily deals with some areas that have a purpose to achieving company's financial goals. Financial management is that managerial activity concerned with planning and controlling the firm's financial resources. In other words it is concerned with acquiring, financing and managing assets to accomplish the overall goal of a business enterprise. Fianncial management comprises the forecasting, planning, organizing, directing, coordinating, and controlling all activities relating to acquisition and applicationof the financial resources of an undertaking in keeping with its financial objective.The company needs funds to meet their requirements in the business. Any kind of business activity depends on the financial transaction. All the activities are concerned with the economic activities and very particular to earning profit. The entire business activities are directly related with making profit. Increasing the profit is the main aim of any kind of economic activity. Financial management may be defined as the way of managing money. The finance function is the procurement of funds and their effective utilization in business concerns. Financial management is an integral part of overall management. It is concerned with the duties of the financial managers in the business firm. Some areas of financial management are solvency, working capital, and profitability.

Good financial management practices demand prominent key management concepts and principles. Lack of knowledge of financial management combined with the business environment's uncertainty often leads companies to severe problems regarding financial performance. If the financial decisions are wrong, the profitability of the company will be adversely affected. Consequently, companies' profitability could be damaged because of inefficient financial management. Companies have often failed due to lack of knowledge of efficient financial management. Efficient financial management is defined as financial management that achieves financial management objectives without wasting financial resources. Financial characteristics of the company are represented by financial ratios derived from financial statements. This information can be used to quantify the position of a company in terms of their profitability, solvency and working capital. In this study, financial characteristics are measured by three variables: solvency, working capital, and profitability derived from financial statements.

In practice, this study is significant for financial management practices in CV Masindo Electric Medan. Results will indicate relationships between solvency, working capital, and profitability and assist the company in improving the performance and profitability of the business by efficiently and effectively managing financial matters. In terms of data analysis, this study applies both descriptive and correlational statistics. Descriptive techniques will be applied to describe characteristics of financial management practices and financial aspects of the company. Statistical techniques such as correlation analysis for measuring the association, t-test, and F test will be applied to test the hypotheses. The findings of this study will be applied to increase the efficiency of financial management practices and improve the profitability of CV Masindo Electric Medan. To provide an in-depth picture of business in which the company operate, financial statement analysis will examine and present information on the background of the condition and business structure of the company. The analytical model for this research is developed in regression analysis. This analytical schema represents the model of the effects of solvency and working capital on profitability. The model demonstrates that profitability is expected to be influenced by solvency and working capital.

Solvency is defined as the ability of an institution to meet its short, middle and long term financial obligations. It is the ability of a business to meet its obligations in the event of cessation of activity or liquidation. A company is considered as solvent if the existing assets exceed or equal total liabilities. However, if total assets are lower than current liabilities, the firm faces an insolvency risk and cannot pay its debts. Solvency is usually measured by ratios. The solvency ratio divides total liabilities by total equity and determines the amount of debt of assets. The relationship between borrowed fund and capital is shown in debt-equity ratio. It can be calculated by dividing outsider funds by shareholder funds. The debt to equity ratio provides an indication of company's capital structure and whether the company is more reliant a borrowing (debts) or shareholders capital (equity) to fund assets and activities. It looks at how the equity capital is leveraged by using debt capital. It compares the relationship of the amount of debt to the amount of equity (net worth).

Solvency impacts a company's ability to obtain loans, financing and investment capital. This is because solvency indicates a company's current and long-term financial health and stability as determined by the ratio of equity to liabilities. In other words, the degree of solvency in a business is measured by the relationship between the liabilities and equity of a business at a given point intime. The combination of debt and equity to finance firm's short term and long-term assets is stated as solvency of the company. Debt and Equity are the basic components of the company's solvency. Solvency is most often referred to as firm's debt-to-equity ratio, which provides insight into how risky a company is. There's an optimal debt equity ratio that maximizes the value of a company and that there is an advantage to financing with debt as interest paid on debt by company is lower than the interest paid on equity. However, a company that is more heavily financed by debt poses greater risk. Maximizing the wealth of shareholders

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requires a perfect combination of debt and equity. Solvency is one of the bank specific factors that has an influence on the performance of a company. A company whose total liabilities exceed total assets is said to be technically insolvent. This means that it may be impossible for the company to repay its liabilities. One of the key financial ratios that is used to measure the solvency of a company is ratio of debt to equity. The ratio indicates the degree of using lieabilities being used by the company and includes both short term and long term debt. This ratio shows the ability of owner's equity in covering the debt from external parties. The lower Debt to Equity ratio will be good for debtor for safety but for stockholder want higher Debt to Equity ratio. Debt to equity ratio indicates the proportionate claims of owners and the outsiders against the firms assets. Debt to equity ratio is a capital structure ratio which evaluates the financial stability of business. All parties including lenders, owners, and management are concern with a company's ability to meet liabilities payments. A high number shows that there are high risks involved and that the company will not be able to pay its liabilities on time.
The components of debt to equity ratio can be seen as follows:

Table 5. The Component of Debt to Equity Ratio in Year 2012-2016

Year	Total Liabilities	Total Equity
2012	14,968,424,625.-	25,033,991,437.-
2013	20,836,735,486.-	25,559,257,331.-
2014	22,159,805,824.-	26,064,789,433.-
2015	25,359,392,326.-	26,563,749,922.-
2016	27,518,313,886.-	27,043,836,409.-

Source : Prepared by Writer (2018)

There is increasing of Debt to Equity Ratio in year 2012-2016. The Debt to Equity Ratio in year 2012 is 59.79 % and Debt to Equity Ratio in year 2016 is 101.75% that it shows the increasing of Debt to Equity Ratio in amount of 41.96%. A high debt/equity ratio generally means that a company has been aggressive in financing its growth with debt. This can result in volatile earnings as a result of the additional interest expense. The increasing of the Debt to Equity Ratio occurs because the stockholders don't want to add the capital stock. The higher the lenders' investment for each money of stockholder's investment, the higher the risk for lenders. The company use loan from debtor to purchasing asset with account payable and bank loan. The company obtain the external fund especially to financing business activities such as purchasing the product. The purchase of product is done with account payable and bank loan. However, the cost of this debt financing may outweigh the return that the company generates on the debt through business activities and become too much for the company to handle. This can lead to difficulties for the company because the company needs to pay the debt and interest

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expense. It can decrease shareholders return.

The debt to equity ratio is a financial ratio indicating the relative proportion of shareholders' equity and debt used to finance a company's assets. The increasing debt to equity ratio is because the company needs fund from liabilities to purchase the product in order to fulfilling the customer's demand. The company needs to purchase sufficient product in making sales. Therefore, the company will make the increase of purchasing of goods to providing the product to customer. Increasing of sales can cause increasing of stock with result that some of product will be obtained with using liabilities. The company uses liabilities without considering the debt to equity ratio with result that the company must make high payment of liabilities and interest expense. The increasing debt to equity in the company can occur because the company doesn't use internal funds such as account receivables. The company doesn't accelerate collection of account receivable in increasing fund in purchasing the stock. The company doesn't make sales of the stock quickly in order that the company can reduce the amount of liabilities. Besides that, the company also uses the short term bank loan as additional fund. The company needs the fund from bank loan to financing the business activities. The company doesn't get sufficient internal fund such as additional fund from owner and profit.

Efficient working capital management is an integral component of the overall co-operate strategy to create shareholder wealth. The way in which working capital is managed can have a significant impact on both liquidity and profitability of the company.Working capital is a common measure of a company's liquidity, efficiency, and overall health. Because it includes cash, inventory, accounts receivable, accounts payable, the portion of debt due within one year, and other short-term accounts. The working capital meets the short-term financial requirements of a business enterprise. The company's working capital reflects the results of company activities. Positive working capital generally indicates that a company is able to pay off its short-term liabilities almost immediately. Negative working capital generally indicates a company is unable to do so. Working capital is the number of current assets minus the number of current liabilities as of a specific date.

Working capital management involves managing current assets and current liabilities, which consists of optimizing current assets. Working capital management involves the relationship between a firm's short –term assets and its short-term liabilities. Working capital is defined as the difference between current assets and current liabilities. Existing assets are the most liquid of the assets, meaning they are cash or can be quickly converted to cash. Current liabilities are any obligations due within one year. The working capital is available to pay your company's current debts and represents the margin of protection the company can give the short-term creditors. Positive Working capital is essential for the company to meet its continuous operational needs. Working capital management is concerned with the problems that arise in managing the current assets, the current liabilities, and the interrelationship between them. The availability of working capital influences the company's ability to meet its trade and short-term debt obligations and remain financially viable. If the current assets do not exceed the current liabilities, the company run the risk of being unable to pay short term creditors in a timely way. The goal of working capital management is to ensure that the company is able to continue its operations and that it has sufficient cash flow to satisfy both maturing short-term debt and upcoming operational expenses. The main objective of the working capital management is to ascertain that a company has the ability to continue operating with sufficient cash flow for payment of both maturing short-term debt and operational expenses. Efficient management of working capital is important in respect of survival and financial condition company.

The current ratio is a working capital ratio that measures a company's ability to pay its current liabilities with current assets. The current ratio also shows the liquidity of the company. Current ratio is calculated by dividing the total current assets by total current liabilities. The higher current ratio and the quick ratio, the better the financial position of the business. The current ratio indicates the ability of a company to pay its current liabilities from current assets and, thus, shows the strength of the company's working capital position. The current ratio is as the ratio of current assets to its current liabilities. The current ratio measures the adequacy of current assets to meet the company's short term liabilities. It reflects whether the company is in a position to meet its liabilities. It is used to evaluate the firm's ability to meet short-term debt such as payment to suppliers. Current assets normally include cash, account receivable and inventories. Current liabilities consist of account payable, short term bank loan and accrued expenses. Short term obligations also known as current liabilities are the liabilities payable within a short period of time, usually one year. The components of Current Ratio in year 2012-2016 are as follows

Table 6. Component of Current Ratio In Year 2012-2016

Year	Total Current Asset	Total Current Liabilities
2012	28,382,253,836	7,446,528,237
2013	30,485,939,956	10,898,640,081
2014	32,682,128,774	12,025,010,864
2015	35,014,245,075	13,160,290,087
2016	36,934,722,951	13,890,567,287

Source : Prepared by Writer (2018)

There is decreasing in the current ratio in the year 2012-2016. The current ratio decreases from 381.15% in the year 2012 to become 265.90% in the year 2016. Thus, for CV Masindo Electric Medan in 2012, the current ratio is 3.81:1 meaning that the company has Rp 3.81 of current assets for each Rp 1.- of current liabilities. In 2016, the current ratio is 2.65:1 meaning that the company has Rp 2.65 of current assets for each Rp 1.- of current liabilities. The good working capital ratio should show that the current assets is higher than current liabilities. The ratio is usually stated as a number of current assets to current liabilities. The decreasing of current ratio can occur because the company doesn't make good management of working capital.

There are high liabilities in conducting the business activities. A low ratio shows that the company isn't running efficiently and can't cover its current debt. The company doesn't have sufficient short term fund to financing the business activities. The increasing account payable and short term bank

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loan show that the company doesn't get high amount of cash from sales of product. The company needs to determine proper amount of inventory. The decreasing current ratio occurs because there is an increase in short-term liabilities from account payable and bank loan. It also occurs because the company cannot make sales quickly because the company cannot manage working capital optimally. The company also makes purchasing of inventory that cannot be sold quickly. Besides that, the company uses the cash to pay the bank loan. The short term bank loan can decrease the company's current asset because the company must pay the principal amount and interest expense amount. The company should make purchase of stock with an account payable and short term bank loan. The increasing of account receivable and inventory shows that the company cannot convert into cash quickly for purchasing and expense payment. The increasing price of product can increase the amount of account payable. Profitability is an important measure of a company's operating success. Profitability is as an ability to make profit from all the business activities of company. It shows how efficiently the management can make profit by using all the resources available. Profitability is also the ability of a given investment to earn a return from its use. Profitability is one of the most important objectives of financial management because one goal of financial management is to maximize the owner's wealth and profitability is very important determinants of performance. Profitability ratios are an indicator for the company's overall efficiency. It's usually used as a measure for earnings generated by the company during a period of time. Profitability ratios measures earning capacity of the firm, and it is considered as an indicator for its growth, success and control. Profitability refers to the ability of a business to earn profit. It shows the efficiency of the business. Profitability ratios measure the results of business operations or overall performance and effectiveness of the company. These ratios measure the profit earning capacity of the company. Profitability ratios measure a company performance and provide an indication of its ability to generate profit. The profits are used to fund business development. The main purpose of most company's operation is to generate a profit. Profitability ratios are often used to measure how effectively a company's management is generating profits on sales, total assets, and stockholders' investments. Profit is a reflection of the success in implementing the activities and operations of the company. The activities of the company affect the profit to be gained by the company. The profitability ratio analysis can be seen in analysis with Return on Asset. Return on asset is calculated as net profit after tax divided by the total assets.This ratio measures the company's operating efficiency based on the firm's generated profits from its total assets. Return on Assets (ROA) is a measures the overall effectiveness of management in generating returns to ordinary shareholders with its available assets. Return on assets (ROA) is positive indicates that of the total assets used to operate to provide profit to the company. Conversely, when a negative return on assets indicates that the use of total assets, the company suffered a loss. So that if a company has a high ROA are positive then the company has a great opportunity to enhance the growth of their own capital. But conversely, if the total assets used by the company are not making a profit it will inhibit the growth of their own capital.

The components of return on asset can be seen as follows:

Table 7.The Component of Return on Asset Ratio in Year 2012-2016

Year	Net Profit	Total Asset
2012	642,979,417.-	40,002,416,062.-

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2013	525,265,894.-	46,395,992,817.-
2014	505,532,102.-	48,224,595,257.-
2015	498,960,489.-	51,923,142,248.-
2016	480,086,487.-	54,562,150,295.-

Source : Prepared by Writer (2018)

There is decreasing in Return on Asset Ratio in year 2012-2016. A business with a high Return on Asset is more likely to be capable of generating cash internally. Return on asset ratio answers whether the company's providing a good return on the capital provided by the company's shareholders. It is the reflection of how effectively a company utilizes asset. Return on asset is another measurement of management performance. Return on asset tells the investor how well a company has used asset to generate profits. Return on asset reveals how much profit a company earned in comparison to the total amount of asset. Return on asset measures how much net income was earned as a percentage of asset. Return on assets (ROA) is a financial ratio that shows the percentage of profit a company earns in relation to its overall resources.It is commonly defined as net income divided by total assets. Return on Assets (ROA) is a form of return on investment (ROI) and measures the profitability of a business in relation to its total assets. This ratio indicates how well a company is performing in making a profit from the capital it has invested in fixed assets. The higher the return, the more productive and efficient management is in utilizing economic resources. The decreasing return on asset occurs because the company cannot effectively use the asset to increase the net income. The low profit from previous year cannot increase the company's ability to increase the sales because the company has lack of fund. Therefore, the company uses fund from bank loan to financing the company's business activities. The company cannot improve the Return on Asset because the company cannot make high sales with result that the company cannot increase the net income. The company doesn't have sufficient funds from shareholders because the company must obtain the fund from liabilities. The bank loan can increase the company's operational expense such as interest expense. Besides that, the stock that cannot be sold quickly will decrease the price of product because there is a new product with low price. The company also doesn't make good promotion in increasing the sales such as providing discount price with result that the customer will choose to buy the product with other company. Some of inventories cannot be sold with high price because there are same product that the customer can get benefit from other company.

The increasing interest expense can also reduce the amount of net income that can be given to shareholders. The increasing of inventory can decrease the return on asset because the company doesn't use the fund to purchasing inventory effectively in making sales. This condition can decrease the net income because the company should cover the fixed cost and expense from administration activities. The owner expects that the company can obtain high net income with result that the owner can get high return from investment in the company. There are some problem in increasing net income for owner such as low product quality. The company doesn't provide the variety of product in accordance with customer's needs. The low net income also has impact in Return on Asset in future because the company doesn't have high fund in conducting the business activities in future. Analysis of financial

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ratio can be used to evaluate company's performance. It can give information about the company's financial condition. The data is obtained related with research variable in order to give description of the problem in the company. The primary goal of this research is to study financial ratios in order to examine the impact of solvency and working capital on profitability. In this study, data of each variable in year 2012-2016 is used to know the impact of solvency and working capital on profitability at CV Masindo Electric Medan in year 2012 to 2016. Debt to Equity Ratio is used as measurement of solvency (X_1). Current Ratio is used as measurement of working capital (X_2). Return on Asset is used as measurement of profitability (Y). The data used in statistic method can beseen as follows:

Table 8. Data of Variables in Statistic Method

Year	Solvency (Debt to Equity Ratio) (X1)	Working Capital Ratio (Current Ratio) (X2)	Profitability (Returnon Asset) (Y)
2012	0.597924013	3.811474681	0.016073515
2013	0.815232431	2.797224216	0.011321363
2014	0.850181655	2.717846091	0.010482869
2015	0.954661612	2.660598273	0.009609597
2016	1.017544755	2.658978729	0.008798892

Source: Prepared by Writer (2018)

Table 9.The Calculation of Mean
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Solvency	5	.60	1.02	.8471	.16104
Working Capital Ratio	5	2.66	3.81	2.9292	.49640
Profitability	5	.01	.02	.0113	.00285
Valid N (listwise)	5				

Source : Prepared by Writer (2018)

From table above, it can be known the mean of each variable. The mean ofsolvency is 0.8471. It shows that the average of solvency in year 2012-2016 at CV Masindo Electric Medan is 0.8471. The mean of working capital ratio is 2.9292. It shows that the average of working capital in year 2012-2016 at CV Masindo Electric Medan is 2.9292. The mean of profitability is 0.0113. It shows that the average of profitability in year 2012-2016 at CV Masindo Electric Medan is 0.0113.

The coefficient of correlation is used to analyzing relationships among variables. This method is used to show the relationship between the variables. The result of coefficient of correlation test is shown below:

Table 10. Coefficient of Correlation
Model Summary

Mod	R	R	Adjusted R Square	Std. Error of the

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el		Square		Estimate
1	.999[a]	.998	.996	.00018

a. Predictors: (Constant), Working Capital, Solvency
Source: Data Processing With SPSS (2018)

From the table above, it can be seen that the coefficient of correlation is 0.999. It shows a strong positive relationship between solvency and working capital to profitability at CV Masindo Electric Medan.

Coefficient of determination (R^2) is done to know proportion dependent variable explained by the independent variables. The result of the coefficient of determination is shown below:

Table 11. Test of Coefficient of Determination

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.999[a]	.998	.996	.00018

b. Predictors: (Constant), Working Capital, Solvency
Source: Data Processing With SPSS (2018)

The result of the determination test shows that the value of the coefficient of determination (R^2) is 0.998. Therefore, 99.8% variation or the changing of profitability is explained by all the independent variables working capital and solvency in CV Masindo Electric Medan. At the same time, the remaining 0.2% is described by variables and other factors that are not included in the research model.

The method of data analysis used in this research is the technique of multiple linear regression analysis. Regression analysis is an equation that expresses the relationship between variables. This analysis is conducted to determine the impact of independent variables on the dependent variable. The main goal is to predict the outcome for dependent variables based on several independents. The model used for the regression analysis is expressed in the equation. The result of linear regression analysis is shown below:

Table 12. Multiple Linear Regression Analysis

Coefficients[a]

	Unstandardized Coefficients	Standardized Coefficie		

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Model				nts	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.012	.002		4.948	.039
	Solvency	-.010	.001	-.550	-7.328	.018
	Working Capital	.003	.000	.472	6.286	.024

a. Dependent Variable: Profitability
Source : Data Processing With SPSS (2018)
Multiple Linear Regression results is as follows:$Y = 0.012 - 0.010\ X_1 + 0.003\ X_2.$

The constant is 0.012. It means that if solvency (X_1) and working capital (X_2) are zero, then profitability (Y) will be at 0.012. The coefficient of regression of solvency (b_1) is 0.010. It means that the increase of solvency in 1 unit can make decreasing in profitability in 0.010 units. The coefficient of regression of working capital (b_2) is 0.003. It means that the increase of working capital in 1 unit can increase profitability in the 0.003 unit.

The T-test is done to know the impact of an independent variable on the dependent variable partially. T count is compared with the value of the T table. The T-test resultis shown below:

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.012	.002		4.948	.039
	Solvency	-.010	.001	-.550	-7.328	.018
	Working Capital	.003	.000	.472	6.286	.024

a. Dependent Variable: Profitability

The results of the T test on solvency (X1) show that T count (-7.328) > T table (-3.18). The result that Tcount of solvency is lower compared with Ttable. It means partial solvency has a significant impact on profitability in CV Masindo Electric Medan. It also shows that there is a negative relationship between solvency and profitability. The results of the T test on working capital(X2) show that Tcount (6.286) > Ttable (3.18). The result of Tcount of working capital is higher compared with Ttable. It means partially working capital have a significant impact on profitability in CV Masindo Electric Medan

The results of the T-test on working capital(X2) show that Tcount (6.286) > Ttable (3.18). The result of Tcount of working capital is higher compared with Ttable. It means partially working capital have a significant impact on profitability in CV Masindo Electric Medan

Table 13. F-Test

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.000	2	.000	519.548	.002[a]
	Residual	.000	2	.000		
	Total	.000	4			

a. Predictors: (Constant), Working Capital, Solvency

b. Dependent Variable: Profitability

Source: Data Processing with SPSS (2018)

Based on the results of the F test, it can be seen that the value of the F count is 519.548. These statistics can be compared with the F table in 9.55. Therefore, it obtained the result that Fcount (519.548) > F table (9.55). All the solvency and working capital have a significant impact simultaneously towards the profitability in CV Masindo Electric Medan.

5. CONCLUSION

. Based on the research result, this research concludes that solvency and working capital have an impact on profitability at CV Masindo Electric Medan. Based on the T-test, the value of Tcount is higher than Ttable. Therefore, the solvencyand working capital have a significant impact on profitability at CV Masindo Electric Medan. Based on the F test, the value of Fcount is higher than Ftable. Therefore, the solvency and working capital have a significant impact onprofitability at CV Masindo Electric Medan simultaneously. The profitability can be explained by working capital and solvency in 99.8% while the remaining in 0.2% is explained by other factors. Based on the working capital analysis, there is decreasing of working capital in the year 2012-2016. It shows that the company doesn't conduct working capital management appropriately. Lack of working capital can make difficulties for the company in developing the business activities because the company has lack of current asset. The company doesn't make sales quickly and collect the cash quickly from customer. The company uses current liabilities for purchasing the stock and paying the expense. Based on solvency analysis, there is increasing of solvency in year 2012-2016. The company has limitation from the internal fund from profit and capital from the owner. Therefore, the company finds the way to conducting business with an external fund such as from account payable and bank loans. The increasing of liabilities can increase the payment of liabilities and interest expenses. Based on profitability analysis, it can be known that there is decreasing of profitability in year 2012-2016. The companycannot increase the net income because the company doesn't increase the sales significantly in covering increases from expense such as increasing price

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of stockand increasing interest expense. The company cannot increase the sales price in high level with result that there is low profit margin.

Based on the research result, the recommendations of this research are as follows: The company should manage the working capital appropriately. The company should maintain the amount of current asset in order that the company can conduct the business in achieving the company's goal such as the sales target. The sufficient cash and stock should be maintained in order that the company can fulfill increasing of customer's demand and paying theexpense. The company should avoid the investment in unproductive assets such as high inventory and high account receivables because the company will lack cash. The company should make sales and collect cash from customers quickly so that the company can make productive business activities. This condition should also decrease the use of liabilities because the company will have difficulties paying the liabilities. Therefore, the company should implement the appropriate business strategy in selling and buying the product effectively to avoid decreasing sales price from old products.
The company should determine the proper amount of liabilities in order that the company can pay principal amount and interest expense. The high liabilities can increase the amount of interest expense. The high-interest expense can decrease profitability. High amount of liabilities also give obstruction for the company's cash flow. The company should use the bank loan with low interest rate and low repayment of liabilities. The company can use the liabilities if the company can ensure that there is high demand from customer. The company uses liabilities in purchasing the product for making high sales. If the company cannot make high sales, the liabilities can decrease the company's profitability because there is high-interest expense and purchasing expense.

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