

Working Capital Management and Profitability of Commercial Banks in Nepal

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Abstract

This paper purposes to analyze effects of working capital management on profitability of commercial banks. Empirical data utilized to explores the association between of working capital management and profitability indicators. Based on empirical data, some major financial indicators, credit to deposit ratio, cash reserve ratio, cash and bank balance to total deposits ratio, working capital turnover ratio and liquidity ratios considered as an independent ratio and return on assets, return on equity, and net profit margin as dependent ratios were calculated. Among 20 of the commercial banks of Nepal, only seven commercial banks are taken as sample for the research work. Data were accumulated from secondary data of annual report of model bank and central bank from 2012 to 2022 by the judgmental sampling. Major financial ratios and statistical tools were utilized for the analysis. Descriptive and inferential statistical tools utilized to obtain outcome. In this study, three regression models were tested, and the ROA, ROE, and NPM models were shown to be statistically significant. In the ROA, ROE, and NPM models, respectively, 41%, 52%, and 55% of the sample variation is explained by independent variables.

Keywords: Commercial bank, profitability, working capital management

Introduction

Background of the Study

Working capital is essential for determining a company's profitability, risk, and ultimately worth. It is an integral element of the several organizations. No enterprise can function without it. It is the vital component of the top level corporate strategy of the organization (Ponsian, 2014; Shrestha, 2019). Utilizing and managing working cash may have a significant short and long term influence on a company's ability to pay its bills, plan for sustainable expansion, and execute other business operations (PHAM et al., 2020). Working capital is crucial to banks and other financial institutions. Bank and other financial institutions rely on its function. <https://doi.org/10.3126/jom.v6i1.58882>

Financial institutions should make an effort to use working capital sensibly and productively (Aldubhani et al. 2022; Gamlath & Rathirane, 2014; Osei et al., 2023).

Working capital management (WCM) is one of the difficulties that commercial banks face in helping businesses meet their temporary financial obligations resulting from financing their operations (AL-Zararee et al., 2022). Working capital is one of a company's assets. The administration of working capital, often known as short-term finance, involves current assets and current liabilities. The ancient Yankee peddler, who would pack his cart with pots, pans and go out to sell his products, is credited with starting the history of working capital. His horse and cart were his fixed assets, and his merchandise was his working capital because it was sold or handed over profitably (Sohail et al., 2016).

Working capital management has become one of the key aspects that affect the profitability of organizations globally (Aldubhani et al., 2022). It is also influence on risk and value. It is one of the vital areas of bank and financial institutions to access the firm's profitability, risk and consequently its value (Sharma, 2013). Making the most of opportunities and reducing risks requires effective management. An organization's working capital is one of its assets. It has become one of the key elements determining the profitability of companies globally, and specifically in the banking industry. It plays vital role to boost company profitability (Bhatia & Srivastava, 2016; Mandiefe, 2016; Singh, 2021).

The profitability of businesses most likely is significantly impacted by how working capital is managed. So, working capital management (WCM) is a critical aspect of monetary management for many businesses. Businesses could have a working capital balance that optimizes their worth (Deloof, 2003; Yahaya & Bala, 2015). It is a crucial corporate financial choice since it has a direct impact on the institutions profitability (Gill et al., 2010; Ponsian, 2014; Raheman & Nasr, 2007).

Working capital management step are indispensable since financial institutions must define the cash flow quantity that must affect their profitability. Working capital management takes into consideration every choice concerning the management of current assets and obligations. This aids in the maintenance and growth of the firms' operations. A business must maintain a precise working capital balance to run smoothly without harming profitability.

The performance of a nation's banking industry has a significant impact on the economy of that country (Nguyen & Nguyen, 2018; Senan et al., 2021). Any company's primary goal is to maximize profit (Akoto, 2013; Ojha, 2019; Shaharudin et al., 2017; Upreti & Venkata, 2021). However, maintaining the institution's liquidity is also a key goal. The issue is that growing earnings at the expense of liquidity might cause the company major issues. Therefore, the bank and financial institution's strategy must strike a compromise between these two goals. Profit and

liquidity are equally important, thus one goal shouldn't be sacrificed for the other. Therefore some research issues emerged to be solved.

The study of working capital is of highest relevance for inner and outer analysis because of its close connection to the actual daily activities of a commercial bank and financial institutions (Shrestha, 2019; Singh 2021). The management of working cash is essential to a business operation for a number of reasons. An organization must first assess the appropriateness of its investment in current assets since failure to do so would severely destroy its liquidity basis. In order to increase operational efficiency, they must secondly choose the right kind of current assets for investment. Thirdly, they must establish the turnover of present assets, which has a big impact on the company's profitability (Nguyen & Nguyen, 2018; Senan et al., 2021; Shrestha, 2019). Therefore, credit to deposit ratio, cash reserve ratio, cash and bank balance to total deposits ratio, working capital turnover ratio and liquidity ratio considered as the working capital indicators and return on assets, return on equity, net profit margin for the profitability.

Research Problems and Objectives

Maintaining the ideal amount of working capital is the main ambition of proficient working capital management in order to increase organizational value. Businesses require the proper amount of operating capital to maximize their value (Gamlath & Rathirane, 2014; Raheman & Nasr, 2007). The working capital indicators credit to deposit ratio, cash reserve ratio, cash and bank balance to total deposits ratio, working capital turnover ratio and liquidity ratio influence on return on assets, return on equity, net profit margin. The following research questions raised in this study explained are as follows:

- Is there any relationship between working capital management and profitability?
- Does the working capital management affect the profitability of Nepalese Commercial Banks?

The main aim of the research work is spotlight on working capital management and its influence on profitability for Nepalese listed commercial banks. To attain the plan, the following objectives are proposed:

- To explore the association between the working capital management and profitability.
- To examine the impact of different components of working capital management on profitability.

Literature Review

Raheman & Nasr (2007) investigated the relationship between working capital management and the company's profitability and liquidity. The sample for the work was discovered from 94 Pakistani firms that were listed on the Karachi Stock Exchange throughout a six-year period, from 1999 to 2004. In addition to Pearson's correlation, regression analysis also

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uses the pooled least square and general least square with cross section weight models for the study. The study found that working capital management elements and firm profitability have a major adverse relationship.

Working capital management's impact on performance was examined by Kaddumi & Ramadan in 2012. Data were obtained from 49 Jordanian industrial companies provided between 2005 and 2009. The research results were found to be strongly associated with the conventional working capital theory's point of view. According to the findings, performance and working capital management were positively associated. It also found Jordanian industrial enterprises choose a cautious approach to maintain working capital financing strategy to increase shareholders' wealth can increase with effective working capital management.

Gamlath & Rathirane (2014) explored the connection between working capital management and the financial success of Sri Lankan commercial banks listed on the Colombo Stock Exchange. The study's goal was to determine the connection between working capital management and profitability and how it affects profitability. Information's were obtained from annual financial statements from listed commercial banks in Sri Lanka covering the years 2007 to 2011. Pearson correlation analyses were used to investigate the relationship between working capital management and profitability, and regression analyses were used to determine the effects on profitability. The variables of the current ratio, loans to deposit ratio, and cash ratio indicate the working capital management, and the profitability included the net profit margin, return on equity, and return on assets.

Yahaya & Bala (2015) studied the effect of working capital management on profitability. The aim was to determine how banks in Nigeria manage their operating capital. The research work was explored the six-year period from 2007 to 2013. The study's data imported from the annual reports and financial statements. Data were analyzed through regression model and a robustness test was performed to determine the validity of statistical judgments. The research found that current, quick ratios and ROA were strongly positively correlated, but cash ratio was inversely but substantially correlated with ROA.

Bhatia & Srivastava (2016) aimed to examine impact of working capital management in a developing market. A panel data considered from 179 companies listed on the Bombay Stock Exchange. The analysis was conducted 2,327 firms between 2000 and 2014 using descriptive and other effects model. Along with accounting performance, market-based performance, business

performance for robustness measured. The result found working capital management and company performances were found to be negatively correlated.

Working capital and its effect on commercial banks' profitability were examined by Mazreku et al. in 2020. The statistical information gathered from the Central Bank of Kosovo's reports and the yearly reports of commercial banks. The information used to construct several indicators, including return on assets, current ratio, debt ratio, and bank size. The result explained financial ratios such as the debt, size and the current ratio had favorably impacted the status of commercial banks.

Singh (2021) investigated the influence of working capital management on the financial performance of the non-financial enterprises listed on the Nepal Stock Exchange. The research was based on panel data analysis. Data were from 2001 to 2018 of 194 firm used for observations listed in NEPSE. The findings showed that lengthier receivable conversion periods and inventory conversion periods had a detrimental effect on the financial performance of non-financial enterprises. The return on equity of Nepalese non-financial enterprises was also negatively impacted by lengthier payment deferral periods.

Upreti & Venkata (2021) conducted research to examine working capital management practices in academics schools in Nepal. Data were collected over a ten-year period from 2008 to 2018, from the annual reports of the sampled schools. The investigation revealed that working capital management was really one of the most significant problems facing Nepalese institutional schools in terms of financial management. The efficiency of institutional schools in Nepal should be evaluated in terms of working capital management.

Aldubhani et al. (2022) researched to examine the profitability of industrial enterprises listed on the Qatar stock market was impacted by working capital management strategic plan. Results were determined by the connection between working capital management and profitability for all industrial businesses. It was considered data of annual report between 2015 and 2019. The report found Profitable firms that profitable firms, have faster systems for collecting receivables and converting cash. Higher corporate profitability is associated with slower turnover times for accounts payable and inventories.

Osei et al. (2023) investigated how working capital management affected Ghanaian manufacturing companies. The work used the effect as the primary estimating approach and the casual effect as the strength test. It was considered the report manufacturing enterprises in Ghana from 2002 to 2022. According to the findings, working capital management was essential since it affects manufacturing companies' ability to continue operating.

All of the aforementioned studies that have been evaluated so far have mostly focused on how much the firm should profit from its operations or how much working capital it should

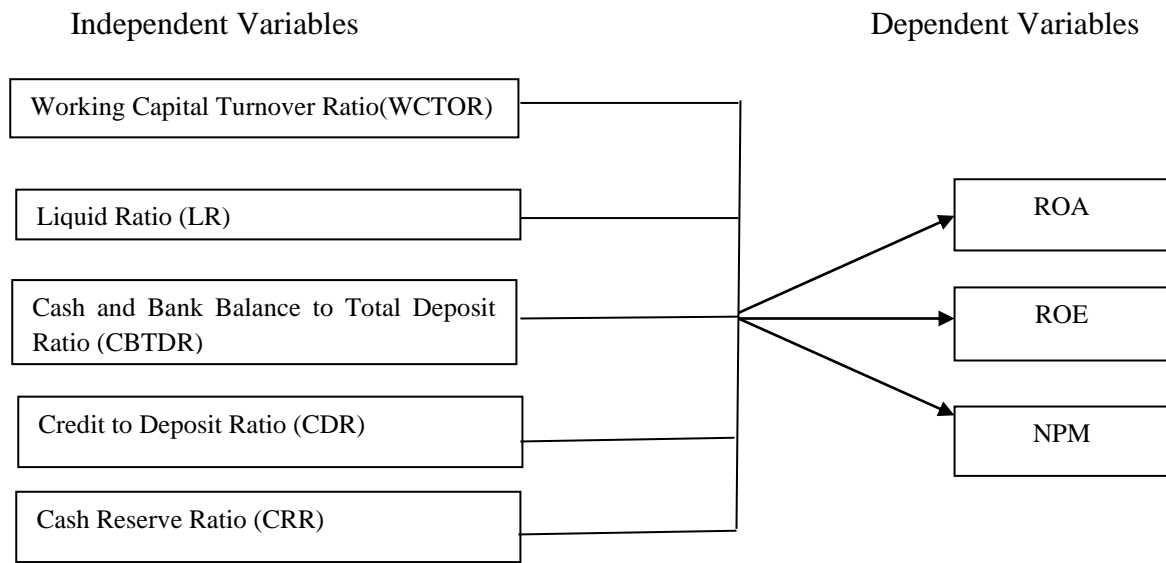
have, but none of the theses have made an effort to determine the link between working capital and profitability. The current research was designed to close this knowledge gap by shedding light on the relationship between the bank's working capital, and profitability. However, this study also considers three models of ROA, ROE and NPM to examine the impact of working capital composition on profitability. It also explores the associations between WCTOR, LR, CBTDR, CDR, and CRR with ROA, ROE and NPM.

Research Framework

The research framework consist dependent and independent variables. Working capital turnover ratio, liquidity ratio, credit to deposit ratio, cash reserve ratio, cash and bank balance to total deposits ratio considered as the independent variables and return on assets, return on equity, net profit margin as the dependent variables.

Figure 1

Research Framework



On the basis of research framework Figure 1, the econometric model is expressed for the study:

$$y = \alpha + \beta x + \varepsilon$$

Where: y is the outcome variable; α is constant; β is the explanatory variable coefficient; x is the explanatory variable vector; and ε is the error term.

Adapting the basic model, following equations can be estimated.

$$ROA_{it} = \beta_0 + \beta_1 WCTOR_{it} + \beta_2 LR_{it} + \beta_3 CBTDR_{it} + \beta_4 CDR_{it} + \beta_5 CRR_{it} + \varepsilon_{it}$$

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$$ROE_{it} = \beta_0 + \beta_1 WCTOR_{it} + \beta_2 LR_{it} + \beta_3 CBTDR_{it} + \beta_4 CDR_{it} + \beta_5 CRR_{it} + \varepsilon_{it}$$

$$NPM_{it} = \beta_0 + \beta_1 WCTOR_{it} + \beta_2 LR_{it} + \beta_3 CBTDR_{it} + \beta_4 CDR_{it} + \beta_5 CRR_{it} + \varepsilon_{it}$$

Where,

ROA_{it} represents Return on assets of bank *i* in year *t*;

ROE_{it} represents Return on equity of bank *i* in year *t*;

NPM_{it} represents Net Profit Margin of bank *i* in year *t*;

CDR_{it} represents Credit to Deposit Ratio of bank *i* in year *t*;

CRR_{it} represents Cash Reserve Ratio of bank *i* in year *t*;

CBTDR_{it} represents Cash and Bank Balance to Total Deposits Ratio of bank *i* in year *t*;

WCTOR_{it} represents Working Capital Turnover Ratio of bank *i* in year *t*;

LR_{it} represents Liquid Ratio of bank *i* in year *t*;

β_0 is the intercept (constant); β_1 , β_2 , β_3 , β_4 and β_5 represent the corresponding slope which addresses the impact coefficients and ε_{it} represents the error term.

Materials and Methods

The research was considered causal comparative research approach. The study's target population included all 20 commercial banks. Among them two government owned bank, two joint venture bank and three private bank considered as a sample for the study. Data were dropped from secondary sources by purposive sampling techniques. The study was based on secondary data imported from published annual reports of several sample banks from 2012 to 2022. These data were put into statistical package for the social sciences software and Microsoft excels for analysis.

Descriptive and inferential statistical tools were used to analyze and interpreted the result. Mean, standard deviation, coefficient of variation, minimum value, and maximum value utilized as a descriptive analysis. Correlation and regression analysis considered as an inferential tool. The study's econometric model was also developed to determine how banks profitability is affected by working capital management.

Results and Discussion

The result and discussions include the information of seven commercial bank of Nepal. Outcomes were explained by descriptive, correlation and regression analysis.

Table 1

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Descriptive Statistics

Variables	Mean	SD	CV	Min.	Max.
ROA	1.62	0.42	25.91	0.83	3.33
ROE	17.35	10.14	58.44	7.57	57.65
NPM	20.33	6.47	31.83	9.00	44.74
WCTOR	1.88	0.87	46.19	0.86	5.55
LR	1.56	0.25	16.31	1.19	2.24
CBTDR	8.69	5.90	67.84	1.50	37.44
CDR	79.18	9.25	11.68	56.73	93.82
CRR	13.77	8.55	62.06	3.10	37.50

Note. (Annual Report from 2012 to 2022)

Table 1 demonstrates the greatest mean value is 79.18, SD 10.14, CV 67.84, minimum value 0.83 and the maximum value is 93.82. The coefficient of variation (CV) and standard deviation (SD) measurements of information risk show that the credit to deposit ratio (CDR) is more consistent with a CV of 11.68 percent and the CBTDR ratio is more erratic with a CV of 67.84 percent. The liquid ratio has the lowest standard deviation, while the ROE ratio has the largest. Relations between different dependent and independent variables are shown in Table 2.

Table 2

Correlation Analysis

Details	ROA	ROE	NPM	WCTOR	LR	CBTDR	CDR	CRR
ROA	1							
ROE	0.428	1						
NPM	0.819	0.512	1					
WCTOR	-0.075	-0.195	-0.202	1				
LR	0.035	0.065	-0.100	-0.419	1			
CBTDR	-0.203	-0.273	-0.466	-0.206	0.147	1		
CDR	-0.242	-0.722	-0.485	0.428	-0.072	0.247	1	
CRR	0.025	0.061	-0.083	0.148	0.302	0.062	0.066	1

Note. (Annual Report from 2012 to 2022)

Table 2 explains return on assets (ROA) is moderately positively correlated with ROE, strongly positively correlated with NPM, low positive with LR and CRR. However, lower degree of negative correlation with CDR, CBTDR and WCTOR. Similarly, return on equity (ROE) is also positive correlation with ROA, NPM, LR and CRR. However, moderate lower degree of negative correlation with WCTOR and CBTDR but a high degree of negative correlation with CDR. Likewise, Net Profit Margin ratio (NPM) strongly positively correlated with ROA and

ROE but very low negative correlation with all of the independent variables. Impact of independent variables on dependent variable ROA was shown in Table 3.

Table 3

Regression Results (ROA)

Variables	Coefficient	t-Stat	p-value
Intercept	2.340	4.159	0.000
WCTOR	-0.012	-0.148	0.030
LR	0.037	0.154	0.878
CBTDR	-0.012	-1.251	0.022
CDR	-0.009	-1.328	0.189
CRR	0.002	0.337	0.037
F = 11.171		Sign (F) = 0.003	
R ² = 0.484		Adj. R ² = 0.412	

Note. (Annual Report from 2012 to 2022)

Table 3 explores return on assets with the intercept, WCTOR, LR, CBTDR, CDR, and CRR. The coefficients and corresponding t-stats and p-values for each variable are shown in the table. In model I, WCTOR, CBTDR and CRR were significant and the remaining variables were insignificant. The regression results show that the coefficient of LR and CRR are positive and the rest of the independent variables have negative coefficients for estimate of ROA. The F-value was calculated to be 11.171 with a significance level of 0.003. It clears that adjusted R² value is 0.412 which indicates all independent variables by 41% and remaining by other variables. It also explains, F. Sig. is 0.003, it means the overall model is significant for the study. Effect of independent variables on dependent variable ROE was shown in Table 4.

Table 4

Regression Results (ROE)

Variables	Coefficient	t-Stat	p-value
Intercept	77.267	8.103	2.12E-11
WCTOR	1.433	1.071	0.014
LR	1.889	0.467	0.643
CBTDR	-0.126	-0.788	0.434
CDR	-0.831	-7.498	2.48E-10
CRR	0.099	0.897	0.373
F = 15.748		Sign (F) = 0.000	

Variables	Coefficient	t-Stat	p-value
R ² = 0.552		Adj. R ² = 0.517	

Note. Annual Report from 2012 to 2022.

Table 4 shows that return on equity examined through the intercept, WCTOR, LR, CBTDR, CDR, and CRR. According to model II, the coefficients of WCTOR, LR, and CRR were positively related to determining ROE, whilst the rest of the variables were negatively associated. ROE model explained only WCTOR indicator was significant. The F-value was calculated to be 15.748 with a significance level of 0.000. Adjusted R² value is 0.517 which indicates all independent variables explain by 52% and remaining by other variables. It also explains, F. Sig. is 0.000, it means the overall model is significant for the analysis. Influence of independent variables on dependent variable NPM was shown in Table 5.

Table 5

Regression Results (NPM)

Variables	Coefficient	t-Stat	p-value
Intercept	50.491	7.180	8.99E-10
WCTOR	-1.831	-1.855	0.048
LR	-4.510	-1.509	0.136
CBTDR	-0.463	-3.927	0.000
CDR	-0.205	-2.503	0.015
CRR	0.040	0.486	0.629
F = 18.581		Sign (F) = 0.000	
R ² = 0.601		Adj. R ² = 0.555	

Note. Annual Report from 2012 to 2022.

According to Table 5 Net profit margin was also analyzed by the intercept, WCTOR, LR, CBTDR, CDR, and CRR. The table shows the coefficients, t-statistics, and p-values for each variable. WCTOR, CBTDR, and CDR were statistically significant with a p-value of less than 0.05 in the NPM model of regression. The F-value was calculated to be 18.581 with a significance level of 0.000. The R-squared value was found to be 0.601 and the adjusted R-squared value was 0.555. The adjusted R² value is 0.555 which indicates all independent variables explain by 56% and remaining by other variables. It also explains, F. Sig. is 0.000, it means the overall model is significant for the research work.

Conclusion

The main purpose of the research was to examine the impact of the working capital management on profitability. In this research, among the three regression models, ROA, ROE and NPM model statistically significant with 41 percent of sample variation in ROA is explained <https://doi.org/10.3126/jom.v6i1.58882>

by independent variables, 52 percent for ROE and 55 percent for NPM. The study reveals that individually each of the variables contributes meaningful information in prediction of working capital and profitability. The research concluded that, the model of the study were statistically significant. Different independent variables WCTOR, LR, CBTDR, CDR and CRR contribute on prediction of ROA, ROE and NPM.

The regression results indicates that, the coefficient of LR and CRR are positive and rest of the independent variables have negative coefficient for estimation of ROA under model I, where CBTDR and CRR were significantly positively associated and remaining variables were associated insignificantly. Under the model II, coefficient of WCTOR, LR and CRR were positively associated with ROE determination whereas rest of the variable are negatively associated with WCTOR and CDR were found to be significant with p-value less than 0.05. In NPM model of regression, only CRR was positively associated with NPM and rest independent variables were negatively correlated, where WCTOR, CBTDR and CDR were statistically significant with p-value being less than 0.05. Under all three regression models, data were best fitted with the ROA, ROE and NPM model.

Implication

The findings of the research work from the commercial banks of Nepal might not apply to other category of bank and financial institutions. This work avoided development bank and finance company. So, other categories of bank and financial institutions, hydropower, manufacturing, non-manufacturing firms and others, build a broader level of understanding of the working capital management and profitability.

Limitations of the Study

As this study was limited to only seven commercial banks, further research should be carried out by other class of banks and financial institutions, manufacturing sectors and several service sectors. The study extremely focused on some major determinant of working capital WCTOR, LR, CBTDR, CDR, and CRR and profitability factors ROA, ROE and NPM. However, it avoids other components of working capital management and profitability. It is only based on annual reports of sample commercial banks from 2012 to 2022.

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