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A Study of Working Capital Management and Profit Ability of Banks in India

Prof Mule Harshada Ravindra[1] and Prof. Ghangale Vivek Vinayak[2]

Assistant Professor, Department of BBA-IB B.Com[1]

Samarth College of Computer Science, Belhe, Maharashtra, India[1]

Assistant Professor, Department of BBA (CA), BBA

Shri Shiv Chhatrapti College Junnar, Maharashtra, India[2]

Abstract: *The purpose of this paper is to assess the impact of the management of working capital (WCM) on results. The main objective of this study is to investigate whether the empirical findings for financial firms such as Banks in India on the relationship between working capital management practices and the profitability of non-financial firms are relevant. We are investigating whether more profitability is correlated with the working capital management of selected Indian Commercial Banks. Our study's results were significantly consistent with the view of the conventional theory of working capital. The findings indicate that the management and efficiency of working capital are positively linked. The results showed that there is a significant positive relationship between the performance of banks and the size of the bank; there is a significant negative relationship between profitability and the cycle of cash conversion and leverage; there is a substantial negative relationship between liquidity and the payment duration and leverage of creditors; and there is a significant positive relationship between liquidity and debtors' collection period, cash conversion cycle and credit risk.*

Keywords: Working Capital Management, Commercial Banks, Profitability, Bank Performance, Liquidity

I. INTRODUCTION

Due to various factors such as determining the composition of the resources for operating and investing in businesses, working capital management is a crucial element in the management of a company's finance. Working capital management often directly affects the company's liquidity as it deals with the management of current assets and liabilities that are necessary for smooth running Current assets are assets that return to the form of cash over a short period of time in the normal course of business, usually within a year and as temporary investment as can be quickly converted into cash when needed. In the field of financial management, working capital management is a very sensitive area that requires deciding on the volume and composition of current assets and their funding. In financial management, every company's goal is to maximize

II. LITERATURE REVIEW

Wang (2002) examined the relationship between liquidity management and operating performance, and that between liquidity management and corporate value for firms. The study

Further revealed that aggressive liquidity management is associated with higher corporate value despite differences in structural characteristics or in the financial system of a firm.

Deloof (2003) investigated the relationship between working capital management and corporate profitability. He used trade credit policy and inventory policy as measured by number of day's accounts receivable, accounts payable and inventories,and the cash conversion cycle as a comprehensive measure of working capital management. Deloof found a significant negative relation between gross operating income and the number of day's accounts receivable, inventories and accounts payable. Thus, he suggests that managers can create value for their shareholders by reducing the number of day's accounts receivable and inventories to a reasonable minimum. Raheman and Nasr (2007) provide further evidence about the relationship of working capital management and profitability. The results show that there is strong negative relationship between variables of WCM and profitability of the firms. It means that as the cash conversion cycle increases, it leads to decreasing profitability of the firm. A Eljelly (2004) It is elucidated that efficient liquidity

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management involves planning and controlling working capitalthat reduces the risk of inability to meet due short-term obligations and avoids excessive investment in these assets. Abdul Raheman and Mohamed Naseer (2007) The study foundthat the cash conversion cycle was of more importance as a measure of liquidity than the current ratio that affects profitability. Arunkumar O. N. and Jayakumar S. (2010) explain how working capital the lifeblood is and controlling nerve centre of the business. Profitability and solvency are two vital aspects of working capital management. The survival and growth of the company depends upon the ability to meet profitability and solvency.

III. STATEMENT OF PROBLEM

Efficient management of working capital focuses on continuing to provide an optimum amount of working capitalto optimize organizational value. By using the cash exchange period, the management of working capital is calculated. Sinceit leads to higher revenue, a longer cash conversion period could improve profitability. However, with the cash conversion period, corporate profitability could also decline if the costs of higher investment in working capital increase faster than the benefits of keeping more inventories and/or giving consumers more commercial credit

3.1 Objectives

- To identify the relationship between the working capital management and profitability of the commercial banks in India.
- To find out the effects of different components of workingcapital management on profitability.

3.2 Hypotheses

- H1: There is a positive relationship between the working capital management and the profitability.
- H2: The working capital management and profitability is positively correlated.
- H3: There is a negative relationship between the working capital management and the profitability.

IV. RESEARCH METHODOLOGY

The study used both descriptive and econometric model to analyses the effect of working capital on profitability of selected banks in India. The analysis is based on the data from the financial statements in the money control website.

4.1 Results and Discussions Descriptive Statistics

Variable	Mean	StandardDeviation	Minimum	Maximum
ROA	2.2891	2.025815	–4	7.5
ROE	11.58306	25.49299	–150.64	37.1
PAT	2.6207	3.1507	–5.7707	1.2708
CR	1.198673	0.3652923	0.3	4
NII	7.3707	6.2207	2.952	2.6008
MPR	10.302	2.266095	6.08	12.8

- PAT - Profit after tax
- CR - Current ratio
- NII - Net interest income
- ROA -Return on asset
- ROE - Return on equity
- MPR - Monetary policy rate

The descriptive statistics made use of mean, median and maximum and minimum. These are used to describe the general behavior of the data. The analysis is based on a panel data from the selected banks' financial statements. The table demonstrates the average and standard deviation of the different variables. The minimum and the maximum value of the variables are also presented in the descriptive statistics of the variables. The mean of return on asset (ROA) is 2.289 and it ranges from –4 to 7.5; the mean of return on equity (ROE) is 11.58 and it ranges from 150 to 37; the mean

of profit after tax (PAT) is 2.62 and it ranges from negative –5.77 to 1.27; the mean value of current ratio (CR) is approximately 1.199 and it ranges from 0.3 to 4; the mean value of net interest income (NII) is 7.34 and it ranges from 2.952 to 2.60; and monetary policy rate (MPR) has a mean value of 10.30 and ranges from 6.08 to 12.8, respectively.
There exists a positive relationship between monetary policy rates and banks profitability. Effective monetary policy and strong working capital management will enhance banksperformance. It was also shown from the analysis that the return on asset (ROA) is a better measure of profitability.
This has shown that there is a significant relationship between working capital management and bank profitability.

V. CONCLUSION

Working capital management, while ensuring an optimum degree of liquidity, has a great effect on profitability. The importance of managers of commercial banks would increase the value of the business, thereby regulating the level of the optimal position of working capital. Working capital management plays the task of retaining cash conversion power in the banking industry to pay its customers according to the requirements so that financial managers can focus in order to preserve their liquidity position and the bank can maximize its profit accordingly. If the banking firms adequately invest their funds in a proper way, this would inevitably improveprofitability.

VI. SCOPE OF FURTHER STUDY

The scope of further research may be extended to the working capital components management including cash, marketable securities, receivables, and inventory management etc. The following recommendations can be made in order to ascertain the value addition of investors' speculation:

1. Working capital management standards and parameters should be established and communicated to the investors.This will help investors to achieve the standard and take better investment decisions.
2. Forecasting working capital management information should be disclosed to the existing and potential investors so that they can motivate to help to achieve the high levelof firm's financial performance.
3. Impact on inflation and exchange rate fluctuations is veryimportant in managing short-term funding so that the financial managers of the specified banking and insurance sectors should always concentrate the optimal fund utilizing movements to attain high financial performance.

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