

Analyzing Working Capital Management in Indian Banks

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Abstract

As far as working capital is concerned, the application of the same can be understood at three levels. First level is the basis of policy framework used maintaining profitability and liquidity of the firm, second level is the flow of working capital is going to affect the accumulation of current assets and at the third level it will directly or indirectly affect the deliverance of current liabilities. This study evaluates the importance of working capital in case of banking system and comparison of public sector and private sector banks in this regard. Basic statistical tools and Kruskal Wallis test is used to analyze the data.

Key Words: Working Capital Management, Public and private sector banks

Introduction

Any organization requires funds for two basic reasons i.e. at the initial level funds are required to incorporate the business and at the second level funds are required to meet the regular operations. Apart from this the companies are also looking forward to different sources of funds to acquire some fixed assets like equipment, machinery, land, fixtures, etc. apparently the money which is used to acquire such fixed kind of assets is the part of fixed capital and this can be recovered in small parts only when the company is abandoned. Now here it is important to mention that once the company is incorporated, short term funds are needed to meet the payments for raw material,

salaries or wages, basic operations, etc. and the amount required or acquired to meet such expenses is named as '*workingCapital*'. Considering a broader view, companies do need working capital to manage the current assets and liabilities and maintaining the equilibrium between the two. Likely the management of working capital is in close contact with the current assets and liabilities. In another sense it can be stated that adequate working capital is required i.e. not more than or less than the requirement. For any of the given firm, the policy followed in terms of working capital is very important because the amount endorsed as the part of working capital is having its impact on the liquidity, profitability and overall health of the organization. Nature of working capital can be understood on three different denominations; at the first level it is the basis of policy framework used maintaining profitability and liquidity of the firm, at the second level the flow of working capital is going to affect the accumulation of current assets and at the third level it will directly or indirectly affect the deliverance of current liabilities. As stated above, after the incorporation of a business, next step is to start the manufacturing operation and for this funds are required, as per the process raw material is converted into semi-finished goods and semi-finished goods are converted into final products. Even in the case of services, working capital is required to arrange all the resources and deliver the final service to the customer. Other than this, process of sales is also included, because via this process revenue is expected to reach the account books. Here it is important to mention that whatever a business produces is not sold instantly, rather there is time gap between the production of goods and sales of goods and in this gap company cannot stop the operation so working capital is the solution. Now the amount of working capital is dependent on the above mentioned gap i.e. longer the gap more working capital is required and shorter the gap less working capital is required.

Objective

The objective of this study is to evaluate the role of working capital in banks and analyze the working capital management of the same. Then on the other hand the researcher will also compare the working capital management of public and private banks.

Hypothesis

H₀: There is no significant difference between working capital management of public sector banks and private sector banks.

H₁: There is significant difference between working capital management of public sector banks and private sector banks.

Research Methodology

Population and sample selection

As far as possible, working capital management is based on previous financial activity based experiences. Thus this study is based on secondary data, but some of the standard practices of working capital are also considered. Then at the second level some data related to outcomes of previous working capital strategies are also compared.

The universe of the study is all the public and private sector banks in India, for the sake of comparison the researcher has considered five private and five public sector banks.

The researcher has considered quota sampling method **Malhotra (2014)** for selecting the sample and the details of selected banks is as follows:

Table 1: Detail of Sampled Banks

S.No.	Public Sector Banks	S.No.	Private Sector Banks
1	Bank of Baroda	1	ICICI Bank
2	Punjab National Bank	2	HDFC Bank
3	Central Bank	3	Kotak Mahindra Bank
4	Bank of India	4	Yes Bank
5	Union Bank	5	IndusInd Bank

Sources of Data

- Most of the studies based on secondary data become very crucial when it comes to selection of data sources. In this present study the researcher has gone through a number of research papers, articles, financial reports and many other related sources. Some of the important sources of secondary data used in this present study are as follows:

Reports

- Report of RBI (2014-2019)
- Annual Reports of Selected Banks (2014-2019)
- Online articles on working capital
- Banks Today, 2014-18

Other sources

- Research journals of national and international repute
- Some issues of Business Today and Business world
- www.moneycontrol.com
- www.financialexpress.com

Tools of study

- Percentages, Averages, trends, etc.
- Kruskal Wallis Test

Software used

- MS Excel
- SPSS Ver. 22.0

Data Analysis and Interpretation

The researcher has considered the following variables to study the management of working capital of selected public and private sector banks:

Table 2: Details of Variables Considered

S.No.	Name of Variable	Explanation
1	ROA (<i>Return on Asset</i>)	This shows the profitability situation of a given company on the basis of total assets and calculated from income of the firm and total assets.
2	Net Income from Interest	Here those assets are considered who are able to generate revenue and even the interest related liabilities, this is calculated from the income statement given in the balance sheet.
3	CR (<i>Current Ratio</i>)	This shows the liquidity position of the company and is calculated on the basis of current assets and current liabilities.
4	PAT (<i>Profit After Tax</i>)	This shows the amount of profit earned by the company after meeting all the respective deduction, including taxation. This is a measure of financial health of the company.
5	ROE (<i>Return on Equity</i>)	This is related to the net income generated on shareholders equity and is calculated on the basis of net income and total assets.
6	RBI	The Reserve bank of India announces the guidelines regarding bank rates every quarter of a financial year and there is far reaching effect of this on the routine functioning of the bank.

Table 3: Summary Statistics of Private Sector Banks

Name of Variable	Average (\bar{X})	S.D. (σ)	Limit Differential (Maximum-Minimum)
ROA (Return on Asset)	3.1974	2.0043	-3.5
Net Income from Interest	6.1695	5.1096	.317
CR (Current Ratio)	1.0725	.2431	3.7
PAT (Profit After Tax)	1.5146	2.9438	-4.0631
ROE (Return on Equity)	9.4922	8.4709	-12.91
RBI	8.204	1.0364	5.98

Table 4: Summary Statistics of Public Sector Banks

Name of Variable	Average (\bar{X})	S.D. (σ)	Limit Differential (Maximum-Minimum)
ROA (Return on Asset)	4.520	2.5174	4.78
Net Income from Interest	7.2219	4.5317	1.438
CR (Current Ratio)	2.3207	1.9982	2.09
PAT (Profit After Tax)	2.4478	1.6873	3.1043
ROE (Return on Equity)	11.5730	7.3548	4.53
RBI	12.8873	1.0364	7.59

Interpretation

The above given analysis of Mean, Standard Deviation and the Limit differential of public and private sector banks shows that there are no major differences in the working capital efficiency of both the section. As a matter of fact a close evaluation depicts that the standard deviation of public sector banks is low as compared to private sector banks and

the limit differential is higher in some of the cases. This is an indication that the public sector banks are making better management of working capital and maintaining the particular flow of funds.

Table 5: Kruskal Wallis Test (Public Sector Banks)

	Technique of Capital Budgeting						
Component	Result	ROE	ROA	NII	PAT	CR	RBI
Total Budget	χ^2	3.04	3.79	5.992	6.733	3.771	1.093
	Sign.	2.19	4.87	3.183	3.762	2.815	0.04
Firm Valuation	χ^2	4.58	6.58	7.665	1.829	3.449	3.087
	Sign.	2.72	1.67	5.827	0.262	2.816	1.73
Years of Incorporation	χ^2	5.87	4.582	6.406	4.109	4.67	3.226
	Sign.	2.49	1.761	3.189	2.23	0.74	1.902

Table 6: Kruskal Wallis Test (Public Sector Banks)

	Technique of Capital Budgeting						
Component	Result	ROE	ROA	NII	PAT	CR	RBI
Total Budget	χ^2	4.29	3.51	5.739	8.534	4.682	2.907
	Sign.	0.24	1.43	2.91	3.780	1.683	0.61
Firm Valuation	χ^2	3.254	7.902	8.84	5.973	6.842	5.042
	Sign.	0.08	1.62	2.54	0.63	1.752	0.819
Years of Incorporation	χ^2	4.72	6.094	5.008	6.531	4.631	7.419
	Sign.	0.57	1.78	1.60	2.08	0.73	1.77

Interpretation

Above given table 5 and 6 state the comparative results of Kruskal Wallis test, this test is applied on the common variables that were selected to compare the structure and management of working capital in the selected public and private banks. According to the parenthesis of the result the difference between the calculated value of Chi square and significance value is the deciding factor. If the difference between the variable is more than the limits then the hypothesis is rejected and if the difference is less, the hypothesis is accepted.

As can be seen from the above table 5 there is a considerable difference in the ROA, ROE and CR of public sector companies and this variation is in the case of '*Value of the firm*' and '*Age of the Firm*'. In rest of the case, values are under the limit of acceptance hence it can be established that in case of public sector banks there is a minimum variation in case of '*Return on Assets*' and '*Profit after Tax*'. This indicates that the public sector banks are able to maintain the level of working capital for the said period of study and are managing their working capital in a favorable manner.

Then on the other hand, in case of private sector banks, we can see that the results are not favorable i.e. in most of the cases there is high level of variation in chi square value and significance value. This is an indication that the private banks are very particular on the process of profit generation and the management of working capital is not at par with the public sector banks.

Then on the other hand the per unit of value of ROE and ROA is statistically significant in case of private sector banks this indicates that all the assets are firmly engaged in income generation and the level of PAT is expected to grow beyond the period of study. In the same scenario, public sector banks are following the old pattern of working capital where projections are majorly made on the basis of previous experiences and not on future growth prospects.

Conclusion

Working capital management is the heart and soul of a given firm and this also depicts the future progress and growth of the same. In case of banks this becomes even more important because it is a financial institution and only the efficient management of capital is the key to success. As the analysis shows that the public sector banks are better performers in case of working capital, as

compared to private sector banks, but again the researcher feels that if the public sector banks make better use of their total assets then the respective profitability may increase. Also the periodic restructuring can also give expected results. Private Banks are regularly estimating the time value of money and incorporating the results in their respective capital management system. In order to make the public sector banks competitive at global level, it is important that they should follow a futuristic approach rather than previous experiences.

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