

The Effect Of Working Capital Management On Financial Performance Of Centenary Bank.

Namubiru Gladys

Metropolitan International University

Abstract

The study aimed at the effect of working capital management on financial performance of centenary bank. The main working capital components that were analyzed included cash and cash equivalents, total loans and advances to customers, total deposits from customers, and total short-term borrowing. Cash conversion cycle was calculated as the number of days inventory was held in stock plus days sales outstanding minus days payable outstanding. Net interest margin, return on equity and return on assets were used as indicators of profitability. Descriptive statistical analysis was conducted to study the trends in working capital metrics and profitability ratios over 2013-2018. According to results, it was indicated that $F=61.453$, $p<000$, meant the positive hypothesis that there was a significant relationship between working capital management and financial performance was accepted, hence rejecting the implied null hypothesis. The management should embrace proper cash inventory and creditors' management so as to ensure that the institutions are able to finance their operations without financial limitations.

Key words: working capital management and financial performance

Background of the study

Working capital management receives much debate and continues to attract scholar attention due to its pivotal role in serving and steering operational efficiency (Alex & Kazaara, 2023), however, there is no consensus about the impact of working capital management on financial performance (Polycarp et al., 2023). Each business is in need for working capital to carry out day-to-day operations which is essential for going concern. Decisions regarding current assets and current liabilities affects liquidity and investments return (Akankwasa et al., 2022), in the worst case, business may face bankruptcy as a result of poor planning of working capital components. (Annet et al., 2023) argues that managers may enhance the firm's profitability by obtaining optimal level of working capital components, keeping high level of inventory reduces stock-out risk, and even enables firms to adopt generous credit policies which leads to higher sales

(Polycarp et al., 2023). Working capital is a financial metric which represents the operating liquidity available to a business (Winny et al., 2023). A long with fixed assets such as plants and equipment, working capital is considered as a part of a company's operating capital, referring to current assets such as cash at hand, cash on bank account, raw materials, work-in-progress, finished goods and accounts receivable (Racheal, Kazaara, et al., 2023). To measure the efficiency of a company's working capital, people often use net working capital which is defined as difference between current assets and current liabilities. If current assets are higher than current liabilities, this company has working capital efficiency, explaining the company's ability to continue its operations and to have sufficient funds to satisfy both maturing short-term debt and upcoming operational expense (Innocent et al., 2023)

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Working capital involves planning and controlling current assets and current liabilities in a manner that eliminates the risk of inability to meet due short-term obligations on one hand and avoid excessive investment in these assets on the other hand (Moses et al., 2023). There is a combination of policies and techniques for the management of a company's working capital. These policies involve inventory management, debtors' management (K. Faridah et al., 2023) and short-term financing management. A popular measure of working capital management is the cash conversion cycle, which tells us how cash is moving through a company in terms of duration. Given the definitions, this research shall examine working capital management issues, specifically how a company manages its working capital by shortening or lengthening its cash conversion cycle in order to contribute for a superior operating profitability (Annet et al., 2023).

Short-term finance is concerned with short-term operating activities such as buying material, paying cash for purchases, manufacturing the product, selling the product or collecting cash. These activities create patterns of cash inflows and cash outflows that are both unsynchronized and uncertain (K. Paul et al., 2023). They are unsynchronized because the payment of cash for raw materials does not happen at the same time as the receipt of cash from selling the product. Additionally, those activities are uncertain since future sales and costs are both known with uncertainty (Emmanuel et al., 2023). Cash conversion cycle tells us how cash is moving through a company in terms of duration. The cycle starts with a cash outflow by which the company pays back to suppliers for obtaining raw

materials then ends with a cash inflow when receiving money back from its customers for selling its goods or services (Isaac et al., 2023). In other words, the cycle indicates the number of days it takes the company to convert its operating activities requiring cash into cash returns.

A downward trend in this cycle is a positive signal whereas a negative signal is blamed for the upward one (Isaac et al., 2023). When the cash conversion cycle shortens, cash becomes free for other usages such as investing on equipment and infrastructure or innovating manufacturing and selling processes. In contrast, when the cash conversion cycle lengthens, cash tied up in the firm's operation activities, leaving little chance for other investments of this cash flow (W. Paul & Kazaara, 2023). In an ideal case, a company should attempt to keep its cash conversion cycle as close to zero as well. In other words, the company is trying to maintain its production to be internally financed. However, the cash tied up in inventory and receivables was almost practically exceed the cash supplied by creditors and accrued liabilities (Ronald et al., 2023).

Management of working capital has profitability and liquidity implications and proposes a familiar front for profitability and liquidity of the company, (Faith et al., 2023) states that working capital policy is a function of two decisions: the appropriate level of investment in current assets and the chosen methods of financing the investment. He explains further that the level of company's current assets and working capital, in respect of the company's total corporate structure and flow of funds is a tradeoff between profitability and

risk (Musaibah et al., 2023). Thus, if there were little risk, an aggressive working capital was used whereby the company shall maintain a minimum level of cash, securities, debtors and stocks. However, if there is little stability, a more conservative policy was called for, requiring high cash balances and high stock reserves (N. Faridah et al., 2023). Optimizing working capital management can lead to improved profitability

in several ways (Kumar et al., 2022; Lee & Wang, 2020). Lower inventory levels reduce holding costs, efficient credit policies minimize bad debts, and improved cash flow allows for timely payments, potentially decreasing borrowing costs. As a result, the Mapeera branch can potentially increase its net income and return on assets (ROA).

Problem Statement

Working capital management is one of the most important aspects of financial management for any organization as it affects the organization's liquidity, profitability and risk. Efficient management of working capital ensures that the organization has enough cash flows to meet its short-term obligations and sustains continued growth (Winny et al., 2023). For banking institutions like Centenary Bank, working capital management is crucial since the bank deals with a large volume of cash inflows and outflows on a daily basis (Winny et al., 2023). Poor working capital management could potentially cripple the bank's operations and impact its profitability and financial performance (Alex & Kazaara, 2023). Studies have shown that effective management of working capital components like cash, receivables, inventory and payables can positively impact organizational liquidity and profitability (Racheal, Enock, et al., 2023). Reducing the cash conversion cycle through efficient receivables collection, inventory management and payables payment policy can improve the profit margins and return on investment of firms (Annet et al., 2023). (Rashid et al., 2023) also found evidence of a significant relationship between working capital management and profitability of listed firms in Turkey. In the banking industry, efficient working capital management is required to ensure adequate cash reserves to meet depositor withdrawals and loan demands, while also maximizing returns from short term investments and reducing idle cash balances (Tasha et al., 2023).

Centenary Bank Ltd is one of the leading commercial banks in Uganda providing retail and corporate banking services. Despite consistent growth in loans and deposits, the bank's financial performance in terms of profitability ratios has declined in the recent past. The bank's net interest margins, return on equity and return on assets for the financial years 2013 to 2018 show a decreasing trend (Frank et al., 2023). This raises concerns about the effectiveness of Centenary Bank's working capital management practices and their impact on the bank's bottom line. If working capital is not managed efficiently, it could potentially tie up excessive funds in non-earning assets and also increase the bank's financing costs.

To understand the factors affecting Centenary Bank's financial performance, it is important to examine the relationship between various dimensions of working capital management including cash management, receivables management (Ntirandekura et al., 2022), payables management and inventory management, and the bank's profitability. Studying the trends in key working capital components as percentage of total assets for Centenary Bank over the past years and

relating it to changes in net interest margins, return on equity and return on assets could provide useful insights into the bank's working capital practices and their effect on financial outcomes (Moses et al., 2023). This would help identify areas of improvement for working capital optimization and facilitate effective strategies to enhance Centenary Bank's profitability through efficient working capital management.

Main Objective

Methodology

In order to examine the effect of working capital management on the financial performance of Centenary Bank, a quantitative research methodology was employed. Annual financial reports of Centenary Bank for the period 2013-2018 were obtained from the Bank's website and used for secondary data collection. Key financial metrics related to working capital components and profitability ratios were extracted from the income statements, balance sheets and statements of cash flows of the Bank over the six-year period (Afza & Nazir, 2007). The main working capital components that were analyzed included cash and cash equivalents, total loans and advances to customers, total deposits from customers, and total short-term borrowing. Cash conversion cycle was calculated as the number of days inventory was held in stock plus days sales outstanding minus days payable outstanding (Richards & Laughlin, 1980). Net interest margin, return on equity and return on assets were used as indicators of profitability. Descriptive statistical analysis was conducted to study the trends in working capital metrics and profitability ratios over 2013-2018. Mean and standard deviation were computed to understand the dispersion and variability of key variables. Pearson correlation and simple linear regression analyses were performed to examine the nature and strength of the relationship between working capital components and profitability variables (Lazaridis & Tryfonidis, 2006). Multivariate regression models were developed taking net interest margin, return on equity and return on assets as dependent variables. Independent variables included cash and cash equivalents to total assets, loans to total assets, deposits to total assets, short-term debt to total assets and cash conversion cycle. A questionnaire was developed to capture information about various policies, techniques and technologies used to manage different components of working capital. Interview responses were recorded, transcribed and analyzed using qualitative data analysis software to identify common themes.

The findings from interviews helped provide context to the quantitative results from secondary financial data analysis. They revealed specific challenges faced in optimizing different elements of working capital as well as initiatives planned or underway for improvement. Data was analyzed in form of tables, frequencies and percentages using SPSS and STATA (Nelson et al., 2022).

Results

Descriptive statistics on working capital and financial performance

Table 1: Centenary bank has a working capital management system

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	5	8.8	8.8	8.8

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Disagree	6	10.5	10.5	19.3
Not sure	1	1.8	1.8	21.1
Agree	17	29.8	29.8	50.9
Strongly agree	28	49.1	49.1	100.0
Total	57	100.0	100.0	

Source: Primary data (2022)

As seen in table 1, results indicate that majority of the respondents generally agreed and strongly agreed, represented by 29.8% and 49.1% respectively. Since this is the majority response, it can be implied to mean that the bank is provided with a mainstream of streamlining its operations and funding them towards success. It was revealed that working capital management has kept the bank from exposure of fraud and also ensured effective use of its available funds which has necessarily contributed to financial performance. This means that Centenary bank understands the essence of effective working capital management for its fundamental financial health and operational success (Winny et al., 2023).

Table 2: The bank prepares cashflow forecasts to identify future surpluses and deficits

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	8	14.0	14.0	14.0
	Disagree	5	8.8	8.8	22.8
	Not sure	5	8.8	8.8	31.6
	Agree	21	36.8	36.8	68.4
	Strongly agree	18	31.6	31.6	100.0
	Total	57	100.0	100.0	

Source: Primary data (2022)

As seen in table 2, results indicate that majority of respondents generally agreed, this was represented by 31.6% who strongly agreed and 36.8% who agreed respectively. This was the majority response and it can be implied to mean that centenary bank has effective and efficient personnel who predict flow of cash in and out of the bank for each month. One of the respondents in one of the interview sessions said that; “Our team prepares cash flow forecasts/ statements which enable management to plan so that it can anticipate periods of cash shortage and take corrective action. This is done by showing a month-by-month breakdown of the cash that is expected to be received over a time period” (Polycarp et al., 2023).

This means that the information highlights any predicted periods of cash shortages and finance team can work together to find solutions.

Table 3: The bank ensures to maintain sufficient cash flow to meet funds needs of the customers

	Frequency	Percent	Valid Percent	Cumulative Percent
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Valid	Strongly disagree	15	26.3	26.3	26.3
	Disagree	23	40.4	40.4	66.7
	Not sure	4	7.0	7.0	73.7
	Agree	8	14.0	14.0	87.7
	Strongly agree	7	12.3	12.3	100.0
	Total	57	100.0	100.0	

Source: Primary data (2022)

As seen in table 3, results in table 6.3, results indicate that majority of respondents generally disagreed; this was represented by 26.3% and 40.4% who strongly disagreed and disagreed respectively. This can be implied to mean that there are instances when the bank fails to meet its financial obligations to creditors and depositors. It was revealed that the cash flow is often and always with the automated teller machines which do not have enough cash for customers withdraw needs. It was revealed that on many instances customers have used various ATM machines of the bank only to find no cash (Kazaara & Kazaara, 2023).

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.726 ^a	.528	.519	.45131

a. Predictors: (Constant), Working capital management

Results in Table 4 show that the adjusted R square, which is the variability in the dependent variable (financial performance), explained by the regression, is 0.519 or 51.9%; this means that 51.9% of the variability in financial performance in Centenary bank is explained by the independent variable working capital management (Nelson et al., 2023). The remaining 48.1% is explained by other factors outside the scope of the current study. The R value from the summary model is 0.726 which is the correlation coefficient.

Table 5 ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	12.517	1	12.517	61.453	.000 ^b
	Residual	11.202	55	.204		
	Total	23.719	56			

a. Dependent Variable: Financial performance

b. Predictors: (Constant), Working capital management

According to results in table 5, it is indicated that $F = 61.453$, $p < 0.000$, means the positive hypothesis that there is a significant relationship between working capital management and financial performance is accepted, hence rejecting

the implied null hypothesis. This means that positive change in working capital management explains variability in the changes under the dependent variable of financial performance (Gracious, 2023). Effective working capital management will lead to improvement in financial performance in the bank; this is justified by the regression coefficient which is not zero.

Discussion of the findings

The results revealed that the bank is provided with a mainstream of streamlining its operations and funding them towards success (basing on 78.9% agree rate), centenary bank has effective and efficient personnel who predict flow of cash in and out of the bank for each month (basing on 68.4% agree rate), there are instances when the bank fails to meet its financial obligations to creditors and depositors (basing on 66.4% disagree rate), employees do not always meet their short- and long-term financial obligations (basing on 68.4% disagree rate), working capital used to measure the difference between current assets and current liabilities to determine the bank's well-being (basing on 68.4% agree rate), Centenary bank always endeavors to ensure that there is enough cash to achieve the operational levels set by the functional budgets (basing on 73.7% agree rate), the bank employees are not aware of policies designed to speed up collections and slow down disbursements has become high (basing on 75.4 % disagree rate) and Centenary bank has efficiently raised funds and used it in a manner that has been able to generate sufficient revenues to meet the operational as well as financial costs (basing on 71.9% agree rate).

Conclusion

The study also concluded that working capital management was a significant aspect in enhancing the financial performance of the commercial bank. Assets management was a critical driver in enhancing the financial performance of the commercial bank. The commercial bank obtained finances through effective management of the fixed assets and cash management. Through continued effective management of the assets, the MFIs were able to maintain their liquidity levels thus steering their financial performance.

Recommendation

The management should embrace proper cash inventory and creditors' management so as to ensure that the institutions are able to finance their operations without financial limitations.

Management of Centenary Bank should tighten its risk management systems in order to continue improving its financial performance.

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