Impact of working capital on firm's profitability

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Abstract

The purpose of this research is to find the relationship between working capital and firm's profitability. Basically, to check the impact of working capital on firms profitability. The quantitative data is used in this research. The financials of the banks support me to check the impact whether it is positive or negative. I used certain test for this research i-e Regression model, Anova and descriptive analysis. These all test conclude that there is a positive relationship between working capital and firms profitability.

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Introduction

JS Bank Limited is an auxiliary of JS Group, a standout amongst the more expanded monetary administration bunches working in Pakistan. Other than exceeding expectations in ventures, for example, asset management, investment banking, securities brokerage, commercial banking, insurance and trade finance. Jahangir Siddiqui Bank Limited was shaped because of merger of JS Investment Bank Limited with the commercial banking operations of American Express Bank Ltd Pakistan.

Jahangir Siddiqui Bank Ltd initiated its performance in Pakistan as a completely planned relies upon 30th Dec. Entire Jahangir Siddiqui Group additionally propelled Islamic banking and fund benefits through setting up a premier Islamic commercial bank beneath the brand of Islamic bank in 2006.

Subsequent to entering the 70th year of his operation, Jahangir Siddiqui Bank Ltd has utilized a large portion of the cities. Right now JSBL have a strong and vast system size of more than 180 units crosswise over 100 urban communities, JSBL is all around ready to extend its system across the country.

HBL was the principal business bank established in 1947 in Pakistan. Consistently, the HBL has developed and has kept up its branch organize as the biggest exclusive keep money with more than 1,700 branches and 2,000 ATMs around the world, with a client base of more than 10 million.

Now a day it has been noticed that the company's financial performance is dramatically changed therefore problematic issue for the company is working capital management. Most of the companies not focused on their working capital management with concentration because they do not consider there big reason for the downfall that's why they suffer problem for the company and in this research will check the impact of equity capital on firm's profitability because this is an alarming signal for the company. Most of the researchers used different variable to measure these impact. Example, Cash Conversion Cycle- Account Receivable Days, Inventories Day turnover and Accounts Payable Days because they stated in their research that if companies want to maintain their working capital management then they should have to minimize their working capital

management. The other variable is debt to total assets which is also necessary to demoralized It affects working capital management of company.

The motivation behind this undertaking is to analyze the effect of equity capital management on the organizations financial performance. The aim behind this research is to show that the equity capital management is the very important factor, implies that executives should discover successful and proficient approaches to manage the cash available for day to day operations in request to accomplish the ideal effect. Quality working capital management leads to increase the cash flows and thus management of the firm needs minor external financing; in this manner, the likelihood of default for the firm is lessened. A significant element in working capital administration is income cycle. It described as the time lag between purchasing the inventory and collection of cash from the sales and your Account receivables. Despite the fact that it has the most development, it has a more prominent enthusiasm for working capital, and the budgetary needs of this organization will be more conspicuous. The cost of profits will also be higher, which will increase the higher default risk, interest rate and reduce profits.

JS bank limited will get more benefit from this research because they get opportunity to know how it competitor utilized their working capital in the day to day operations and the management of the JS bank will easily identifying the master way and actions that they can be implement instantly. Moreover after the successful execution of the cash flows company haven't required external finance and indisputably improved organization financial performance. Numerous analysts have taken a gander at capital prerequisites from alternate points of view and in various conditions. The accompanying was extremely fascinating for our research Abbasali Pourghizan and Milad Emam Jalili Pourchari, experimentally, investigated the influence of working capital on firm's Profitability and judgment of stock market of Tehran Stock Exchange. Considering this goal, in 2006-2010, a sample of companies was registered and reviewed at the Stock Exchange of Tehran. In this research, variables have also been utilized to measure the impact of these two factors. Now the Predicted results from this research shows that there is an impact of working capital management on company's profitability and the results

conclude that management can raise their profitability by diminishing the cash conversion cycle and debt to total assets.

Literature review

Most exact investigations bolster conventional convictions about contributing and gainfulness, which will positively affect venture company's decrease in productivity (forceful strategy) by diminishing the proportion of current advantages for add up to resources. Deloof (2003) broke down a case of Belgian organizations, and Wang (2002) dissected a case of Japanese and Taiwanese organizations, and underscored that the administration of working capital significantly affected corporate benefit and increment gainfulness by lessening the quantity of day by day accounts and diminishing stock. A short money cycle and net business cycle are identified with the organization's better execution. What's more, effective, productive capital administration is fundamental for making an incentive for investors. Shane Swann (1998) detailed a comparative specimen from a US firm, however utilized the Net Trading Cycle (NTC) as a complete instrument for working capital administration and demonstrated a negative connection among NTC and benefit. In any case, this relationship was exceptionally noteworthy when breaks down were found for a specific industry (Soenen, 1993). Jose, et al. (1996) led an industry investigation of the business and measured the present liquidity utilizing the income cycle. Controlling the business and size contrasts, they presume that liquidity administration is connected to more benefits for different enterprises.

In any case, it is not quite the same as conventional convictions that putting more in the process of giving birth capital (moderate legislative issues) may likewise build gainfulness. At the point where the stock holds up, the cost of intrusions in the creation procedure, decreased supply costs, assurance from value changes and diminished business because of item deficiencies (Blinder and Maccini, 1991). Czyzewski and Hicks (1992) Moreover, we presume that associations that have a more prominent profit for assets have higher money related imperatives yet don't see liquidity administration as a steady proportion of money and settled resources.

In one research (Deloof 2003) argued that most of the company's invested a large amount of liquidity in working capital management. Hence, they were expected that the managed working capital increase the firm's profitability What's more, I think the connection between the working capital and profitability is critical. After the regression and correlation test the result stated that there is a significant inverse relationship between company's income and the number of Account Receivables Days . Account Payables and Inventories. It means that If company has less profitable so it takes long period of time to pay its creditors because there is a significant negative relationship between these two variables. So it is important for the company to maintain its cash conversion cycle to increase their profitability. The Cash conversion cycle also plays a vital role to maintaining the working capital which impact on your profitability.

Shane and Swann (1998) underscore that working capital management was essential to make an incentive for investors (Shareholders). It was a venture way management significantly affected benefit and liquidity. Connection between the length of the net advertising cycle, corporate profitability, and hazard balanced stocks return utilizing the connection and elapse examination by industry and capital were explored severity Then found a solid negative connection between net lengths. The business cycle and its benefit [. Furthermore, shorter net exchange courses were likewise connected increasing stock comes back with higher hazard.

Methodology

Examined the effect of working capital on profitability, the main focus of this research is to check the impact of labor capital management on firm's performance. The regression analysis was anticipated with a sample of 255 firms listed on Thai Stock exchange from 2007 to 2009. Hence, the finding showed that there is an inverse relationship between profit and (CCC) Cash Conversion Cycle. It

means that (CCC) cash conversion cycle increase the profitability will decline. Simply, the research conclude indirectly is that the working capital management interrupts your profitability.

This research is rely on multiple case study as methodology because in my research there is comparison between the two organizations "JS Bank" and "HBL" that's why it's based on multiple case study. The case study will focus on the financial performance of the two companies that whether changes in working capital affect the firm's profitability.

The literature review and my working experience in "JS Bank" as well as with the use of secondary data. It will help me to identify many problems and the impact of business capital on organizations performance. The secondary data will be composed in the research to answer the questions.

The deductive approach is being acquire for this industry project where the financial performance for the "JS BANK" will be basically broke down and contrasted with the benchmark organization "HBL". The reason for adopting the deductive approach is that because we are testing on previous data of the organization.

Basically this research will be based on quantitative research. Secondary data will be used in this research because we are working on past data. This information is a sort of little data that another person gathers for another reason. To check the impact of working capital on firms performance the secondary data will be helpful because with the help of their published accounts we will conclude the findings that whether it affects or not on your profitability. The published accounts of "JS Bank" and "HBL" are enough to give the conclusions on this research.

This task agrees to the moral necessities of research as per the materials specified. Members will be dealt with in an ethical way and will be dealt with to control potential disability. We furnish the best outcomes with the assistance of past research and data gave by banks. Moreover for this project took permission from JS and HBL management and filled up the consent form from their upper level management. Data will be safe and confidential and will only be used for this research.

Results and Findings

HBL financial Highlights

Progress at A Glance 2007 To 2016 - Consolidated										
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
(Rs. in Millions)										
Balance Sheet										
Total Equity	60,239	66,309	84,270	96,251	109,414	132,730	142,209	169,595	182,820	196,269
Total Assets	689,001	749,807	863,325	924,699	1,039,847	1,160,474	1,719,271	1,864,618	2,216,433	2,507,182
Total Deposits	531,298	597,091	682,750	747,375	835,632	1,214,964	1,401,230	1,524,645	1,634,944	1,885,959
Advances (net of provision)	382,173	456,356	454,662	459,750	457,368	499,818	563,701	600,020	637,384	748,466
Investments (net of provision)	175,197	129,833	216,468	254,909	418,604	797,095	826,082	922,691	1,270,834	1,344,405
Operating Results										
Total Revenue	39,875	48,133	53,830	59,757	71,181	73,720	74,339	92,008	114,753	113,013
Total Expenditure	10,382	21,814	25,149	24,953	30,380	31,114	36,854	42,227	49,713	55,598
Operating Profit	21,493	26,320	30,682	34,804	40,801	42,607	37,485	49,781	65,040	57,417
Provision against advances & others	7,823	9,388	9,300	7,764	6,745	7,945	1,351	1,531	4,754	692
Profit before taxation	13,670	16,932	21,382	27,040	34,056	35,562	36,133	48,250	60,286	56,725
Profit after taxation	9,921	10,864	13,401	17,034	22,161	22,792	23,027	31,483	35,162	34,208
Others										
Home Remittances	79,322	84,230	126,870	158,693	206,236	271,090	307,630	386,197	474,068	450,851
Imports	263,089	410,073	349,650	410,127	417,646	393,047	476,574	401,464	385,846	390,224
Exports	208,208	273,711	321,733	388,585	419,969	404,019	427,845	442,093	450,522	359,214
Number of Branches	1,489	1,508	1,494	1,501	1,506	1,540	1,594	1,644	1,716	1,731
Financial Ratios										
Return on average assets (RoA)	1.5%	1.5%	1.7%	1.9%	2.1%	1.7%	1.4%	1.8%	1.7%	1.4%
Return on average equity (RoE)	17.5%	17.2%	17.8%	18.9%	21.4%	18.8%	16.8%	20.2%	19.9%	16.1%
Non-interest income to total revenue	25.1%	23.4%	20.7%	21.4%	20.8%	21.6%	26.0%	25.5%	31.9%	27.3%
Net NPL to net advances ratio	1.9%	2.6%	3.3%	2.7%	2.7%	3.2%	2.7%	2.7%	1.7%	1.4%
Asset quality ratio (NPL ratio)	6.9%	8.3%	10.1%	10.7%	11.2%	10.9%	12.7%	11.9%	10.9%	9.2%
Coverage ratio	78.9%	70.1%	71.5%	79.6%	81.5%	77.1%	83.5%	83.2%	90.1%	91.2%
Advances to deposits - gross	75.9%	81.1%	71.8%	67.2%	53.9%	44.9%	45.0%	43.7%	43.3%	43.3%
Capital adequacy ratio (CAR)	13.6%	11.4%	13.3%	14.6%	15.6%	15.3%	15.4%	16.2%	17.0%	15.5%

JS Bank Financial Highlights

JS BANK LIMITED
Financial Highlights

	December 31, 2017	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013	December 31, 2012
PKR million						
Deposits	290,078	226,099	141,840	108,740	80,916	62,544
Investments - net	169,612	133,727	119,030	84,258	42,679	46,259
Advances - net	184,140	93,794	76,666	62,433	33,763	20,955
Total Assets	388,309	264,700	218,475	176,717	112,771	81,570
Total Equity	15,669	15,650	15,969	13,080	8,935	8,967
Gross Mark-up Income	20,381	15,081	15,328	11,113	6,850	6,023
Net Mark-up Income	6,242	5,728	5,590	3,854	2,325	2,265
Non-Mark-up Income	4,051	4,861	3,290	2,591	1,678	1,806
Non Mark-up Expenses	8,347	6,848	4,824	3,951	3,036	2,553
Profit Before Taxation	1,621	3,390	3,174	1,609	501	979
Profit After Taxation	973	2,077	2,026	1,061	351	709
EPS - Rs(s)	0.74	1.77	1.74	0.99	0.33	0.70
P/E ratio - no. of times	10.16	6.11	4.45	7.21	13.64	8.39
Breakup value per share - Rs.	13.64	13.62	13.06	10.70	8.33	8.36
Number of Branches - numbers	323	307	277	238	211	185
Number of Employees - numbers	4,960	4,163	2,946	2,442	2,082	1,715

UNCONSOLIDATED STATEMENT OF
FINANCIAL POSITION
As at December 31, 2015

	2015	2014	2015	2014
	US dollars in 1000	US dollars in 1000	US dollars in 1000	US dollars in 1000
ASSETS				
Cash and balances with treasury banks	1,060,523	80,579	1,100,322	1,001,220
Balances with other banks	5,372	3,439	5,372	1,412,232
Investments - net	1,107,776	804,417	1,107,776	84,217,238
Advances - net	791,800	500,012	791,800	89,433,128
Operating fixed assets	43,666	35,063	43,666	5,766,830
Deferred tax assets - net	2,056,153	1,200,171	2,056,153	1,707,163
Other assets	1,354,202	1,038,181	1,354,202	1,038,181
LIABILITIES				
Bills payable	15,366	13,774	15,366	13,774
Deposits and other accounts	3,214,862	1,682,884	3,214,862	1,682,884
Subordinated loans	1,354,202	1,038,181	1,354,202	1,038,181
Liabilities against assets subject to finance lease	16,187	4,244	16,187	4,244
Deferred tax liabilities - net	1,354,202	1,038,181	1,354,202	1,038,181
Other liabilities	1,354,202	1,038,181	1,354,202	1,038,181
NET ASSETS				
Share capital	102,992	102,992	102,992	102,992
Reserves and other equity	102,992	102,992	102,992	102,992
Preference shares	14,321	14,321	14,321	14,321
Minority interest	8,726	8,726	8,726	8,726
Surplus on revaluation of assets - net of tax	1,354,202	1,038,181	1,354,202	1,038,181
Contingencies and commitments	1,354,202	1,038,181	1,354,202	1,038,181

The annexed notes from 1 to 46 and annexure 1 and 2 form an integral part of these unconsolidated financial statements.

Chairman President and Chief Executive Officer Director Director
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Table1: Financial data of JSBL and HBL

Bank	Years	ROA	ROE	Current Ratio	Working Capital turnover	Total Asset turnover	Net Margin	Working Capital
HBL	2012	1.70%	18.80%	1.07	3.98	3.59	29.99%	14,506,459
	2013	1.40%	16.80%	1.79	0.55	3.21	30.66%	100,803,193
	2014	1.80%	20.20%	1.89	0.62	3.70	34.18%	111,881,172
	2015	1.70%	19.90%	1.18	1.70	3.52	31.43%	46,060,533
	2016	1.40%	18.10%	1.38	0.79	3.27	31.20%	103,274,206
JSBL	2012	0.86%	7.90%	1.14	1.87	2.78	0.31	1,211,000
	2013	0.31%	3.92%	1.39	0.28	2.06	0.15	8,309,034
	2014	0.60%	8.11%	0.51	(0.15)	2.18	0.28	(25,657,188)
	2015	0.92%	12.68%	0.38	(0.16)	2.56	0.36	(35,041,756)
	2016	0.78%	12.47%	2.15	0.39	2.16	0.36	14,732,017

Table2: Correlations

Correlations	ROA	ROE	CR	WCT	TAT	NM	WC
ROA Pearson	1	.964**	.240	.528	.975**	.925**	.662*
Correlation							
Sig. (2-tailed)		.000	.505	.117	.000	.000	.037
N	10	10	10	10	10	10	10
ROE Pearson	.964**	1	.278	.388	.891**	.898**	.665*
Correlation							
Sig. (2-tailed)	.000		.436	.268	.001	.000	.036
N	10	10	10	10	10	10	10
CR Pearson	.240	.278	1	.003	.190	.341	.670*
Correlation							
Sig. (2-tailed)	.505	.436		.993	.598	.335	.034
N	10	10	10	10	10	10	10
WCT Pearson	.528	.388	.003	1	.579	.428	.044
Correlation							
Sig. (2-tailed)	.117	.268	.993		.079	.218	.905
N	10	10	10	10	10	10	10
TAT Pearson	.975**	.891**	.190	.579	1	.927**	.676*
Correlation							
Sig. (2-tailed)	.000	.001	.598	.079		.000	.032
N	10	10	10	10	10	10	10
NM Pearson	.925**	.898**	.341	.428	.927**	1	.824**
Correlation							
Sig. (2-tailed)	.000	.000	.335	.218	.000		.003
N	10	10	10	10	10	10	10
WC Pearson	.662*	.665*	.670*	.044	.676*	.824**	1
Correlation							
Sig. (2-tailed)	.037	.036	.034	.905	.032	.003	
N	10	10	10	10	10	10	10

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

The above mentioned results show the proper picture of our research. It tells you that which variable affects the firm's profitability. The result shows that ROE, TAT and WC has a significant relationship

with the firm's profitability so it means that null hypothesis should be rejected and alternative hypothesis has to be accepted because the sig value of these variables is less than 0.05. It describes that there is a relationship between them so if these variables increase or decrease it affects the firm's profitability. The other variable CR and WCT has the insignificant relationship between them because there sig value is greater than 0.05

Table 3: Descriptive statistics

	N	Min	Max	Mean	Std. Dev	Variance
ROA	10	.31	1.80	1.1470	.52009	.270
ROE	10	3.92	20.20	13.8880	5.75815	33.156
CR	10	.38	2.15	1.2880	.56639	.321
WCT	10	-.16	3.98	.9870	1.25056	1.564
TAT	10	2.06	3.70	2.9030	.63552	.404
NM	10	.15	34.18	15.8920	16.47858	271.544
WC	10	-35041756	1.12E8	3.4008E7	5.40418E7	2.921E15

Valid N (listwise)=10

Regression

Table 4: Variables entered/removed^b

Model	Variables Entered	Variables Removed	Method
1	WC ^a	.	Enter

a. All requested variables entered.

b. Dependent Variable: NM

Table 5: Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.824 ^a	.679	.638	9.90924

a. Predictors: (Constant), WC

The above readings of the result show that there is a 68% variation in dependent variable explained by model (independent variable). The "R-Square" explain variation and the "R" value shows the correlation value so it means there is 0.824 correlations between the dependent and independent variable.

Table 6: ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1658.349	1	1658.349	16.889	.003 ^a
	Residual	785.544	8	98.193		
	Total	2443.893	9			

a. Predictors: (Constant), WC

b. Dependent Variable: NM

Table 7: Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1 (Constant)	7.350	3.760		1.955	.086		
WC	2.512	.000	.824	4.110	.003	1.000	1.000

Dependent Variable: NM

Tolerances =1.000 VIF =1.000

The another finding describes that overall model is significant and there is a relationship between the variables because the sig value of the anova model is less than 0.05 so null hypothesis should be rejected and alternative have accepted. The “t” value also proves that there is significant relationship between these variables because “t” value is greater than 2 which is 4.110. The Tolerance value tells about the model with its own threshold that if its value is greater than 0.5 so it means its significant impact on the model and now comes to “VIF” value which explains that if the value is between 0-2 so it’s acceptable otherwise reject. There is “VIF” value describes that there is a significant impact between the variables. There is relationship between Working capital and firm’s profitability.

In this investigation, the anticipated variable of working capital on the organization's benefit is tried by two hypotheses.

Table 8: Hypothesis results

Hypothesis	Testing Specification	Empirical Conclusion
H0: Firm profitability is significantly affected by working capital.	0.003	Accepted

Conclusion

Most Pakistani organizations contribute a lot of money in working capital. Along these lines, you can anticipate that a way will oversee capital available for use It significantly affects the benefit of these organizations. We have found a significant positive relationship between the working capital and firm’s profitability. These results suggest that if company wants to maintain their position in the market and gets the good results so they have to properly workout on their working capital.

Regarding our hypothesis we conclude that our alternative hypothesis that there is a relationship between working capital and firms profitability is the one to be accepted and therefore we reject the null hypothesis.

The conclusions are in confirmation with the other researchers which I mentioned in the literature review who also found a positive relationship between the measures of working capital management including ROE and total asset turnover and net margin.

The main discussion in this research was to analyzing the performance of the company with respect to certain variables. We saw

the findings tell us about the impact of variables on firm’s performance. The major aim to check the impact of working capital on firm’s profitability. As we saw in the findings that it’s proven the working capital plays a vital role in company’s performance.

From the outcomes found in this investigation, which incorporates the accompanying, a few approach inquiries can likewise be utilized working capital administration ought to be a worry of all financial sectors and the necessities of the organization because every area of your company is related with the working capital. The cash conversion cycle is important for the working capital it has to be improved and for this treasury department of the company must be experienced. The effective policy is formulated for these components. If working capital maintained properly so your gross working capital turnover and current asset to total asset has also the significant positive impact on profitability.

Recommendations

In view of the above investigation, it can be inferred that these outcomes can be more reinforced if organizations deal with their capital in a more proficient manner. Capital administration signifies "overseeing current resources and current liabilities and financing of these present resources. In the event that these organizations deal with their income appropriately, Accounts receivable and stock legitimately, this will in the long run increment the benefit of these organizations.

Later on, putting resources into Pakistan is genuinely necessary. We propose that further research be directed on a comparable theme with various organizations and broaden the example years. Additionally look into extension may reach out to the administration of staff capital parts, including money, buyer securities, obligation and stock administration.

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