**IMPACT OF ADEQUATE WORKING CAPITAL ON PROFITABILITY OF BANKS**

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**Abstract**

This project examines the issues of working capital management in banks specifically, it focuses attention on an efficient and effective. Working Capital Management using the case study of Wema Bank Plc. The study examines and expatiates on the merit of maintaining an efficient working capital portfolio in an organization. It focuses on the efficiently managed. In the project, a critical assessment of the relationship between the various components of working capital as an important tools to enhancing profitability and liquidity as well as the rudiment for the effective working capital management within any organization was done. It was discovered that fro a bank to maximize the wealth of its share holders the bank should earn a steady amount of profit from its operation. Hence the bank needs an adequate working capital level to generate sufficient returns. Working capital in bank refers to items required by the bank to ensure efficient delivery of its operation on day-to-day basis. If can be defined as the excess of current asset over current asset over current liabilities. Liquidity ratio measure the ability of the bank to meet its current obligation as they become due, failure of bank to meet its obligation due to lack of sufficient liquidity would result in loss of customers goodwill.

 **CHAPTER ONE**

**INTRODUCTION**

* 1. **Background of the study**

Many corporate bodies into problems because of mismanagement of working capital and inability to determine the effectiveness of working capital component on the organization performance. Working capital is the backbone of any organization be it finance / bank, manufacturing or trading. It is so because, if working capital of a company is not properly managed, it could lead to the total breakdown and closure of the organization. Hence, management of working capital is being critically analyzed in this research work.

Working capital in bank refers to items requires by the banks to ensure efficient delivery of its operation on day-to-day basis. It can be defined as the excess of current asset over current liabilities. Generally, working capital management is concerned with the managing of:

1. **Current Asset:** Which majorly consist of stock, trade debtor’s payment or creditors balance at bank, and cash in hand? Although the component of each variables of current asset depends on the type of industry in question e.g while stock may be subdivided into raw materials, work in progress and finished good. In banking industry their stock is mainly money or cash.
2. **Current Liabilities:** Trade creditors, accrued, expenses, taxation. Furthermore, cash is an important component of working capital, a pointer to this fact is the even though cash constituted the smallest portion of the total current asset yet management of any organization devotes considerable time to its management. The following are the consequence of efficient management of working capital.

i.              Regular operation will not be possible, as inadequacy of funds will course unplanned closure.

ii.            The incessant slowing down of banking activities leading to inability to needs customers. This may lead to bank customers closing their account and going for other banks that are effective in bank transaction.

iii.          Low level of availability of find may hamper the extension of credit and bring about inability to meet customer with drawals.

iv.          Deposit that has matured may be impossible to repay which may resort into litigation and consequent upon which bank may be wand up

 **1.2 STATEMENT OF THE PROBLEMS**

These are the problems that are envisaged in this research work. The first part relates to problems directly attributable to the research topic, and the other relates to the problems encountered in the course of carrying out the research work.

The following problems relate to working capital as a research topic:

1.   In ability to determine the adequate level of working capital may affect availability of funds in banks which may in turn affect loan portfolio since there was not enough fund to give out as loan.

2.   Where a bank experience increase in its number of customers, there is likelihood that demand for credit will increase. If it does, and funds are not available, level of operation will be hampered.

The following problems are assumed to be encountered in the course of carrying out the research work.

i. The response to the questionnaires by the respondents cannot be taken to the totally correct .

ii. There is also the problem of implementation of working capital policies even when it was correctly formulated.

iii.  It is also assumed that to some extent. The respondents to the questionnaire might not want to supply important information considered confidential to the bank.

* 1. **OBJECTIVES OF THE STUDY**

**The objectives of the study are;**

1. To ascertain the effective working capital management in bank will improve level of profitability.
2. To ascertain the relationship between adequate working capital and bank profitability
3. To ascertain the impact of adequate working capital on profitability of bank

**1.4 RESEARCH HYPOTHESES**

For the successful completion of the study, the following research hypotheses were formulated by the researcher;

**H0:** there is no effective working capital management in bank will improve level of profitability.

**H1:** there is effective working capital management in bank will improve level of profitability.

**H02:** there is no relationship between adequate working capital and bank profitability

**H2:** there is relationship between adequate working capital and bank profitability

* 1. **SIGNIFICANCE OF THE STUDY**

This research works reveal how important working capitals improve tremendously profitability of bank. The research conducted in this research show how availability of adequate working capital on increase profitability of Wema Bank tremendous. The impact of working capital helps bank to achieve its aims and objectives of profit making. It also helps in the efficiency of operation and this improve customer confidence on banker due to the fact that banker always able to meet customer demand at any time he/she demand for his / her money. In addition, the research conducted shows that availability of working capital helps bank to employ its excess or surplus working capital an viable project and investment that improve its profitability tremendously. Finally, the availability of adequate working capital is a great tools to help banks to improve its profitability tremendously. It is very important that every bank should try to increase their working capital which will have positive impact on their profitability and improve their efficiency of operation.

* 1. **SCOPE AND LIMITATION OF THE STUDY**

This study will cover several areas to shows the impacts of adequate working capital on profitability of banks with special reference to Wema Bank Plc, Apata Ibadan. This study will also include the literature review of different sholars on the subject matter i.e. the benefits to the derived on adequate working capital in relating to profitability of banks.  The researcher encounters some constrain which limited the scope of the study;

 **a) AVAILABILITY OF RESEARCH MATERIAL:** The research material available to the researcher is insufficient, thereby limiting the study

**b) TIME:** The time frame allocated to the study does not enhance wider coverage as the researcher has to combine other academic activities and examinations with the study.

**c) Organizational privacy**: Limited Access to the selected auditing firm makes it difficult to get all the necessary and required information concerning the activities

**1.7** **DEFINITION OF TERMS**

 **Cash Budget:**This is the summary statement of a firm’s expected cash inflows and outflows over a projected period of time.

**Cross Working Capital:**This refers to the firm’s investment in current asset which can be easily converted into cash within an accounting year.

**Working Capital:**This is the excess of current assets over current liabilities. The surplus which would be available for work.

**Liabilities:**This is a debt owe by the company and will be settled at stipulated time.

**Prepayment:**This is the payment made now and y the benefit in advance or nearest future.

**Cash:**This is the money which the bank can disburse easily and immediately without restriction.

**Collateral Security:**This is the real or tangible asset which can be used as surely for the loan secure.

**Overdraft:**It is a relationship exists between banker and customer whereby bank allows its customer to withdraw funds in excess up to a certain specified limit during a stipulated period.

**1.8 ORGANIZATION OF THE STUDY**

This research work is organized in five chapters, for easy understanding, as follows

Chapter one is concern with the introduction, which consist of the (overview, of the study), historical background, statement of problem, objectives of the study, research hypotheses, significance of the study, scope and limitation of the study, definition of terms and historical background of the study. Chapter two highlights the theoretical framework on which the study is based, thus the review of related literature. Chapter three deals on the research design and methodology adopted in the study. Chapter four concentrate on the data collection and analysis and presentation of finding. Chapter five gives summary, conclusion, and recommendations made of the study

**CHAPTER TWO**

**REVIEW OF RELATED LITERATURE**

**2.1** **INTRODUCTION**

Many research works have been undertaken by various authors on working capital management: The followings are interesting and useful for this research: Eljelly (2004), examined the relation between profitability and liquidity, as measured by current ratio and cash gap (cash conversion cycle) on a sample of joint stock companies in Saudi Arabia using correlation and regression analysis. The study found that the cash conversion cycle was of more importance as a measure of liquidity than the current ratio that affects profitability. The size variable was found to have significant effect on profitability at the industry level. The results were stable and had important implications for liquidity management in various Saudi companies. First, it was clear that there was a negative relationship between profitability and liquidity indicators such as current ratio and cash gap in the Saudi sample examined. Deloof (2003) assesses the relationship between working capital management and profitability. Using correlation and regression tests he found a significant negative relationship between gross operating income and the number of days accounts receivable, inventories and accounts payable of Belgian firms. On basis of these results he suggested that managers could create value for their shareholders by reducing the number of days’ accounts receivable and inventories to a reasonable minimum. The negative relationship between accounts payable and profitability is consistent with the view that less profitable firms wait longer to pay their bills (Raheman and Nasr, 2007). Ghosh & Maji (2003), made an attempt to examine the efficiency of working capital management of the Indian cement companies during 1992 – 1993 to 2001 – 2002. For measuring the efficiency of working capital management, performance, utilization, and overall efficiency indices were calculated instead of using some common working capital management ratios. Setting industry norms as target-efficiency levels of the individual firms, this paper also tested the speed of achieving that target level of efficiency by an individual firm during the period of study. Findings of the study indicated that the Indian Cement Industry as a whole did not perform remarkably well during this period. Shin & Soenen (1998) have highlighted that efficient Working Capital Management is very important for creating value for the shareholders. The way working capital is being managed makes it effective and had a significant impact on both profitability and liquidity. The relationship between the length of Net Trading Cycle, corporate profitability and risk adjusted stock return was examined using correlation and regression analysis, by industry and capital intensity. They found a strong negative relationship between lengths of the firm’s net trading Cycle and its profitability. In addition, shorter net trade cycles were associated with higher risk adjusted stock returns. Smith & Begemann (1997) emphasized that those who promoted working capital theory shared that profitability and liquidity comprised the salient goals of effective working capital. The problem arose because the maximization of the firm's returns could seriously threaten its liquidity, and the pursuit of liquidity had a tendency to dilute returns. This article evaluated the association between traditional and alternative working capital measures and return on investment (ROI), specifically in industrial firms listed on the Johannesburg Stock Exchange (JSE). The problem under investigation was to establish whether the more recently developed alternative working capital concepts showed improved association with return on investment to that of traditional working capital ratios or not. Results indicated that there were no significant differences amongst the years with respect to the independent variables. The results of their stepwise regression corroborated that total current liabilities divided by funds flow accounted for most of the variability in Return on Investment (ROI). The statistical test results showed that a traditional working capital leverage ratio, current liabilities divided by funds flow, displayed the greatest associations with return on investment. Well known liquidity concepts such as the current and quick ratios registered insignificant All the above studies provided a solid base and gives idea regarding working capital management and its components. They also gives the results and conclusions of those researches already conducted on the same area for different countries and environment from different aspects. Because of the fact that these researches were done in different countries, this study has developed a methodology that will suit the peculiarities of Nigerian environment which the study base

**2.2 WORKING CAPITAL MANAGEMENT**

Most empirical study on working capital management (WCM) is based on large non-financial corporate institutions. Obviously, financial management of banks and these non-financial enterprises bear strong similarities. However, there is a significant disparity which substantiates the study of financial management of banks. Since banks of developing countries experience difficulties in accessing external finance, they rely more strongly on internally savings funds than larger banks from developed economies. Working capital management thus plays an important role in the liquidity of banks in developing countries (Berger et al, 2001). There is an assertion confirmed that working capital related problems such as overtrading are cited among the most significant reasons for the failure of rural and community banks (Owusu-Frimpong, 2008). Shin and Soenen (1998) examined the relationship between working capital management and value creation for shareholders. They examined this relationship by using correlation and regression analysis, by industry, and working capital intensity. Using a COMPUSTAT sample of 58,985 firm years covering the period 1975-1994, they found a strong negative relationship between the length of the firm's net-trade cycle (NTC) and its profitability. Based on the findings, they suggest that one possible way to create shareholder value is to reduce firm’s NTC. Following pioneer work of Shin and Soenen (1998), Deloof (2003) study found a strong significant relationship between the measures of WCM and corporate profitability. Their findings suggest that managers can increase profitability by reducing the number of days of accounts receivable and inventories. In a related study, Wang (2002) emphasized that increase in profitability can be achieved by reducing number of day’s accounts receivable and reducing inventories. Thus, a shorter Cash Conversion Cycle (CCC) and net trade cycle is related to better performance of the firms. Furthermore, efficient working capital management is very important to create value for the shareholders. Lazaridis and Tryfonidis (2006) investigated the relationship of corporate profitability and working capital management for firms listed at Athens Stock Exchange. They reported that there is statistically significant relationship between profitability measured by gross operating profit and the Cash Conversion Cycle. Furthermore, Managers can create profit by correctly handling the individual components of working capital to an optimal level. Similar results with very few disparities are shown in Kenya (Mathuva, 2009), Nigeria (Falope and Ajilore, 2009) and Istanbul (Uyar, 2009). Raheman and Nasr (2007) studied the relationship between working capital management and corporate profitability for 94 firms listed on Karachi Stock Exchange using static measure of liquidity and ongoing operating measure of working capital management during 1999-2004. It was found that there exist a negative relation between working capital management measures and profitability. On the contrary, Sharma and Kumar (2011) present findings which significantly depart from the various international studies conducted in different markets that working capital management and profitability is positively correlated in Indian companies. The study further reveals that inventory number of days and number of days accounts payable is negatively correlated with a firm’s profitability, whereas number of days accounts receivables and cash conversion period exhibit a positive relationship with corporate profitability. This study was based on a sample of 263 non-financial BSE 500 firms listed at the Bombay Stock (BSE) from 2000 to 2008 and the data evaluated using OLS multiple regression. Thus, it could be concluded that even though finding common proxies for working capital policy is difficult, researchers seem to agree, generally (with few exceptions), that CASH CONVERSION CYCLE has a significantly negative relationship with firm profitability even though most of these evidence are from non-financial firms. Also, it is evidenced that the importance of good working capital management practices transcends industry or firm size (Shah and Sana, 2006; Howorth and Westhead, 2003; Peel and Wilson, 1996; Padachi, 2006; and Garcia-Teruel and Martinez-Solano, 2007). At this juncture, empirical literature will mainly centre on the relationships between working capital components (inventory, debtors, creditors, and cash) and profitability, the effect of cash conversion cycle on profitability as well as issues that border on trade-off between liquidity and profitability. We shall now concentrate discussions along these above mentioned channels of determining a firm’s profitability profile through effective liquidity management.

 **2.3 LIQUIDITY AND PROFITABILITY TRADE-OFF**

Liquidity is a flow concept and as such refers to ability of a firm to generate adequate cash from both internal and external sources to meet its cash requirements (Egbide and Enyi, 2008). It is technically known as solvency meaning the firm’s continuous ability to meet maturing obligations. While profitability refers to the firm’s ability to generate revenues in excess of the cost of generating such revenues. Most empirical studies have established liquidity and profitability as the most important goals of working capital management and have been found to be universally associated with each other (Raheman and Nasir 2007, Shin and Soenen, 1998; Pandey, 2005) Van-Horne and Wachowicz, 2005). Trade-off between the dual goals of working capital management as shown in Smith (1980) which is similar to risk-return trade-off has increasingly been supported by many empirical findings (Nguyena, 2007; Eljelly, 2004 and Raheman and Nasir, 2007). For example, Yunq-Janq (2002) examines relationship between liquidity and profitability for firms in Japan and Taiwan and discovers that aggressive liquidity management enhances operating performance which leads to achievement of higher corporate values for both countries despite differences in both their structural characteristics and financial systems. Along the same line of investigation, Eljelly (2004), examines a sample of 29 joint stock companies in Saudi Arabia and finds a strong negative relationship between liquidity and profitability. These two studies evidence the need to balance profitability with liquidity. This is because policies that tend to maximize profitability tend to reduce liquidity and vice versa for the particular business firm under consideration (Raheman and Nasir, 2007 and Uremadu, 1998, 2000, 2001). Although profitability target is seen as the ultimate objective of an enterprise but preserving liquidity is equally important. Hence, increasing profitability at the expense of liquidity or vise versa can bring serious problems to the firm. Therefore there arises the need to balance profitability goal with liquidity goal of business enterprise in order to maintain a balanced working capital position of the particular firm and (to) ensure its survival at all times. To have higher profitability, a firm will have to maintain a relatively low level of current assets (Pandey, 2005; Van-Horne, and Wachowicz, 2005, Egbide and Enyi, 2008). The implication of this is to ensure that fewer funds are tied up in idle current assets, but the firm adopting this strategy will be sacrificing solvency thereby exposing itself to greater risk of cash shortage and stock outs. On the other hand, to ensure solvency, a firm has to be very liquid which means maintaining a relatively large investments in current assets. The latter policy ensures that the firm is able to meet its short term obligations as well as fills sales orders and ensures smooth production schedule. This will, however, reduce profitability since a large proportion of funds are tied up in current assets (Egbide and Enyi, 2008 and Uremadu, 2004). Nonetheless, profitability and liquidity objectives should not be mistaken to be permanently mutually exclusive as there may arise situations where both move in the same direction. For example, Lyroudi and Lazaridis (2000) demonstrate through a study that there exists no linear relationship between liquidity and profitability among the Greek food industry. In support of this view, Byrnes (2003) reports that Dell Corporation generated huge amount of liquidity and extra-ordinary high returns at the same time. His study reveals that while it took Dell forty five days to pay its vendors, its debtor’s collection period was four days. That this strategy has crafted a sort of cash engine which enabled them to finance the company’s rapid growth and limited its external financing needs as well as has yielded high returns. Finally, this argument can equally be supported by a view that liquidity is a matter of degree and lack of it can limit advantages of favorable discounts, profitable opportunities, management actions and coverage of current obligations (Egbide and Enyi, 2008). In the same way, illiquidity often precedes lower profitability, restricted opportunities, loss of owner control, loss of capital investment, insolvency and bankruptcy (Anon, 2003).

**2.4 INVENTORY MANAGEMENT AND PROFITABILITY**

Inventory management is a part of investment decisions and like every other investment, investment in inventories is expected to yield a return higher than the cost of that investment, that is, investment in inventories is expected to positively impact on the company’s profitability. (Egbide and Enyi, 2008). Pandey (2005) rightly states that inventory policy will maximize a firm’s value at a point in which incremental or marginal return from that investment in inventory equals the incremental or marginal cost of funds used to finance it. Consistent with the above proposition, Lazaridis and Tryfonidis (2005) state that the optimum level of inventories will have a direct effect on profitability since it will release working capital resources which, in turn, will be converted into business cycle or that will raise inventory level in order to respond to higher demands. Byrnes (2003) reports that inventory management of Dell Corporation focused on lowering inventory by 50 percent, improving lead time by 50 percent, reducing assembly costs by 30 percent, and reducing obsolete with its reducing variance between supply and demands, launched the company to higher levels of liquidity and profitability. It thereby led to the slogan “Dell Manages Profitability, Not Inventory”.

**2.5 DEBTORS’ MANAGEMENT AND PROFITABILITY OBJECTIVE**

All efforts the financial manager makes in setting credit standard, credit terms and credit collection periods are geared towards establishing an optimal credit policy for the firm. An optimal credit policy is one which maximizes a firm’s value, and it is a point where Pandey (2005) assets that the incremental or marginal rate of return of an investment is equal to the incremental or marginal cost of funds used to finance that investment. Optimal credit policy invariably translates into an optimal investment in receivables which, in turn, maximizes firm’s value or net-worth. Usually a firm lengthens its credit period to raise its operating profit through expanded sales turnover program. However, there will be net increase in operating profit only when the cost of extended credit period is less than the incremental operating profit (Pandey, 2005 and Egbide and Enyi, 2008). The foregoing captures consensus of experts’ on views on the relationship between receivables management and profitability objective of most business firms. Hence, Damilola (2005) opines that the purpose of offering credit is to maximize profits. Similarly, Lazaridis and Tryfonidis (2005) maintain that credit periods whether from suppliers or granted to customers, in most cases, have a positive impact on profitability. However, due to associated risks inherent in credit policy, financial managers, most often, vary the level of receivables in keeping with the trade-off between profitability and risk. Pike and Chang (2001) maintain that given a significant investment in accounts receivables by most large firms, credit management policy choices and practices may have important implications on corporate value and that successful management of resources will often lead to higher corporate profitability. Hence, there should be a guided flexibility introduced in managing a firm’s customers (debtors) credit extension policy.

**2.6 BANK PROFITABILITY**

 The term profitability refers to the ability of the business organization to maintain its profit year after year. Profitability, according to Sanni, (2006) is a situation where the income generated during a given period exceeds the expenses incurred over the same length of time for the sole purpose of generating income. Athanasoglou, Brissimis & Delis (2005) on their own part defined bank profitability as the ability of a bank to generate revenue in excess of cost, in relation to the bank’s capital base. They further assert that, a sound and profitable banking sector is better able to withstand negative shocks and contribute to the stability of the financial system. Although variously, authors have given different definition, basically it is about sustaining the ability of having excess income over expenses. Profitability is therefore importance because it is the main (purpose) of business

**2.7 EMPIRICAL LITERATURE**

Empirically, numerous studies have been conducted to examine the effect of working capital management on profitability in the different countries of the world and various results were found which let to varying conclusions. The quest to know if the cause of corporate failure is due to the lack of short term financing or inefficient management of working capital pushed Peel and Wilson (1996) to examined working capital and financial management in the small firm sector of UK. They made use of quantitative survey method and concluded that for small and growing businesses, an efficient management of working capital is a vital component of success and survival that is both profitability and liquidity. They also highlighted that smaller firms should adopt formal working capital management routines in order to reduce the probability of business failure as well as to enhance business performance. Given these peculiarities, they stressed the efficient management of working capital and good credit management practice as being pivotal to the health and performance of small firm sector. Vida et al (2011) made use of 101 companies listed on Tehran Stock Exchange (TSE) over the period of 2004-2008 to study the relationship between working capital management and corporate profitability of firms. Using the multivariate regression and Pearson correlation, the finding reveals that the cash conversion cycle which is a key measure of working capital management has a relationship with corporate profitability. Sharma (2011) further examined the effect of working capital management on the profitability of Indian firms. With the use of the ordinary least square regression technique, the study reveals that working capital management and profitability are positively correlated in Indian companies. The study also reveals that inventory days and payables days are negatively correlated with a firm’s profitability whereas receivable days and the cash conversion period exhibit a positive relationship with a firm’s profitability. Contrary to Sharma(2011), using the Pearson’s correlation method Meryem (2011) noticed that there is a negative relationship between corporate profitability and the different working capital components, they resolved that Tunisian small and medium sized enterprises dealing in exports should shorten their cash conversion cycle by reducing the number of days of receivables and inventories to increase their profitability. Erik (2012) equally used the cash conversion cycle as a determinant of working capital management efficiency and gross operating profitability as an indicator of profitability for Finnish and Swedish public companies. Using regression models and correlation analysis his results show that there is a significant effect of working capital management on corporate profitability, he thus concluded that long conversion cycles have a negative effect on profitability while shorter cash conversion cycle will increase profitability. He highlighted that by effectively managing each part of working capital a company can increase cash flow and thus shareholders wealth. Senthilmani (2013) carried out a research on the impact of working capital management on profitability in UK manufacturing industries using the Pearson’s correlation technique. The results show that there is no significant relationship between the working capital components (receivable days, payable days, inventory days, cash conversion cycle) and profitability of the firm. His results suggest that managers need to focus on core business principles to maximize shareholders wealth. In their study, Ntui et al (2014) carried out a study to find out the effect of working capital management on company profitability. Using the Pearson’s correlation and Ordinary least square regression analysis, the following findings were made; there exist a positive relationship between the cash conversion cycle and profitability of a firm which means that as the cash conversion cycle increases, company profitability increases; there is a negative relationship between liquidity and profitability showing that as liquidity decreases, profitability increases. The results equally portray the existence of a negative relationship between average collection period and profitability, thus any decrease in the number of days a company receives payment from sales leads to an increase in profitability. On the other hand, the relationship between average payment period and profitability is positive and statistically significant, therefore the longer a company takes to pay its creditors, the more profitable she becomes. Using the panel data least square method of regression, Ahmed (2015) examined the effect of working capital management on profitability of selected manufacturing companies in Nigeria, he noticed a significant relationship between working capital and profitability. He equally concluded that working capital management has a significant impact on profitability of manufacturing companies and recommended that companies should manage their cash, receivables, inventories and payables with view of reducing the cash conversion cycle so as to increase their profitability. Using average collection period to capture working capital, Sabo (2015) examined the impact of working capital management on corporate profitability. He made use of regression analysis; his results show that there is a positive relationship between average collection period and profitability. He concluded that cash collected should be re-invested into short term investment to generate profits and that idle cash or excessive liquidity is costly and does not lead to profitability. A review of empirical literature shows that the effect of working capital on the profitability of firms has been excessively studied in manufacturing companies. Ordinary least square regression and Pearson correlation was used as technical of analysis but their findings differ The general trend indicates that effective management of working capital leads to an increase in profitability Sabo (2015),Ahmed (2015) , Ntui et al (2014) while Sharma(2011), finds contrary results. While carrying out the research, the researcher didn’t find directly related research topics carried out in Cameroon. Therefore, the current researcher believed that the problem is almost untouched and that there is a knowledge gap on the area. This implies that lack of proper research study on the area gives limited awareness to Cameroonian company managers in relation to working capital management to increase company profitability. Hence, this study is intended to explore the case of Cameroon. More so, the researcher realised that a lot of investigation on working capital management has been carried out in manufacturing sector while other sectors like the banking sector has barely been touched. Therefore, the current research will investigate the extent of the effect of working capital management on profitability in the banking sector, thereby filling the gap in literature.

**2.7 THEORETICAL FRAMEWORK**

**Fisher’s Separation Theory**

According to Hochstein (2001), the idea of the Fisher’s Separation theory is “Given perfect and complete financial capital markets, the production decision (investment) is seen as governed solely by an objective market criterion (maximizing wealth) with no regard to the individual’s subjective preferences that enter into the consumption decision”. The Fisher’s separation theory tries to explain that companies should avoid confusion between an investment and financing investments. It is therefore important for a company to make a distinction how much to invest in working capital and how to finance working capital. Gross working capital is the investment while net working capital is the financing of working capital. This difference between investment and financing working capital can be clearly understood by defining terms like gross working capital and net working capital. Gross working capital or working capital refers to investment in current assets like receivables, inventory and cash while net working capital indicates how much a company has to invest of its long term capital to finance its working capital or in simple terms net working capital refers to the difference between current assets and current liabilities. With this in mind, a company has to attend both factors while optimising working capital and maximizing profitability. Capital investment is characterised by investment in machinery, plant and equipment and in short term investments. The financing of these investments depends on the structure of the company. The decision to finance the net working capital depends on its sign, if the net working capital is positive (current assets exceeds current liabilities), it will be financed with long term capital such as equity or long term borrowing but should in case the net working capital is negative (current liabilities exceed current assets), it will be financed with short term capital which can increase the cost of borrowing significantly.

**Liquidity Preference theory**

 This theory seeks to examine the reasons why people or companies hold money in liquid form, given that it does not yield any revenue. According to the theory, money is the most liquid asset. Liquidity is an attribute to an asset. The more quickly an asset is converted into money, the more liquid the asset. When an asset is easily converted into cash, it provides liquidity for the company in its day-to-day operations, it enables the company to pay its short term obligations and it is used as well to invest in working capital. The demand for liquidity is determined by three motives which are transactionary, speculative and precautionary motives.

**CHAPTER THREE**

**RESEARCH METHODOLOGY**

* 1. **Research design**

The researcher used descriptive research survey design in building up this project work the choice of this research design was considered appropriate because of its advantages of identifying attributes of a large population from a group of individuals. The design was suitable for the study as the study sought to impact of adequate working capital on profitability of banks

* 1. **Sources of data collection**

Data were collected from two main sources namely:

(i)Primary source and

(ii)Secondary source

**Primary source:**

These are materials of statistical investigation which were collected by the research for a particular purpose. They can be obtained through a survey, observation questionnaire or as experiment; the researcher has adopted the questionnaire method for this study.

**Secondary source:**

These are data from textbook Journal handset etc. they arise as byproducts of the same other purposes. Example administration, various other unpublished works and write ups were also used.

* 1. **Population of the study**

Population of a study is a group of persons or aggregate items, things the researcher is interested in getting information on impact of adequate working capital on profitability of banks. 200 staff of wema bank, Apata, Ibadan were selected randomly by the researcher as the population of the study.

* 1. **Sample and sampling procedure**

Sample is the set people or items which constitute part of a given population sampling. Due to large size of the target population, the researcher used the Taro Yamani formula to arrive at the sample population of the study.

n= N

 1+N(e)2

n= 200

1+200(0.05)2

= 200

1+200(0.0025)

= 200 200

1+0.5 = 1.5 = 133.

**3.5 Instrument for data collection**

The major research instrument used is the questionnaires. This was appropriately moderated. They staff were administered with the questionnaires to complete, with or without disclosing their identities. The questionnaire was designed to obtain sufficient and relevant information from the respondents. The primary data contained information extracted from the questionnaires in which the respondents were required to give specific answer to a question by ticking in front of an appropriate answer and administered the same on staff of the organizations. The questionnaires contained about 16 structured questions which were divided into sections A and B.

* 1. **Validation of the research instrument**

The questionnaire used as the research instrument was subjected to face its validation. This research instrument (questionnaire) adopted was adequately checked and validated by the supervisor his contributions and corrections were included into the final draft of the research instrument used.

* 1. **Method of data analysis**

The data collected was not an end in itself but it served as a means to an end. The end being the use of the required data to understand the various situations it is with a view to making valuable recommendations and contributions. To this end, the data collected has to be analysis for any meaningful interpretation to come out with some results. It is for this reason that the following methods were adopted in the research project for the analysis of the data collected. For a comprehensive analysis of data collected, emphasis was laid on the use of absolute numbers frequencies of responses and percentages. Answers to the research questions were provided through the comparison of the percentage of workers response to each statement in the questionnaire related to any specified question being considered.

Frequency in this study refers to the arrangement of responses in order of magnitude or occurrence while percentage refers to the arrangements of the responses in order of their proportion.

The simple percentage method is believed to be straight forward easy to interpret and understand method.

The researcher therefore chooses the simple percentage as the method to use.

The formula for percentage is shown as.

% = f/N x 100/1

Where f = frequency of respondents response

N = Total Number of response of the sample

100 = Consistency in the percentage of respondents for each item contained in questions.

**CHAPTER FOUR**

**PRESENTATION ANALYSIS INTERPRETATION OF DATA**

**4.1 Introduction**

Efforts will be made at this stage to present, analyze and interpret the data collected during the field survey. This presentation will be based on the responses from the completed questionnaires. The result of this exercise will be summarized in tabular forms for easy references and analysis. It will also show answers to questions relating to the research questions for this research study. The researcher employed simple percentage in the analysis.

**DATA ANALYSIS**

The data collected from the respondents were analyzed in tabular form with simple percentage for easy understanding.

A total of 133(one hundred and thirty three) questionnaires were distributed and 133 questionnaires were returned.

Question 1

Gender distribution of the respondents.

TABLE I

|  |
| --- |
| **Gender distribution of the respondents** |
| Response | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Male | 77 | 57.9 | 57.9 | 57.9 |
| Female | 56 | 42.1 | 42.1 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

From the above table it shows that 57.9% of the respondents were male while 42.1% of the respondents were female.

Question 2

The positions held by respondents

TABLE II

|  |
| --- |
| **The positions held by respondents** |
| Response | Frequency | Percent | Valid Percent | Cumulative Percent |
| **Valid** | HRMS  | 37 | 27.8 | 27.8 | 27.8 |
| Accountants  | 50 | 37.6 | 37.6 | 65.4 |
| ICT analysts  | 23 | 17.3 | 17.3 | 82.7 |
| Senior staff  | 23 | 17.3 | 17.3 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

 The above tables shown that 37 respondents which represent27.8% of the respondents are human resource managers, 50 respondents which represents 37.6 % accountants 23 respondents which represents 17.3% of the respondents are ICT analysts, while 23 respondents which represents 17.3% of the respondents senior staff

**TEST OF HYPOTHESES**

There is no effective working capital management in bank will improve level of profitability.

**Table III**

|  |
| --- |
| **there is no effective working capital management in bank will improve level of profitability.**  |
| Response  | Observed N | Expected N | Residual |
| Agreed | 40 | 33.3 | 6.8 |
| strongly agreed | 50 | 33.3 | 16.8 |
| Disagreed | 26 | 33.3 | -7.3 |
| strongly disagreed | 17 | 33.3 | -16.3 |
| Total | 133 |  |  |

|  |
| --- |
|  |
|  | **there is no effective working capital management in bank will improve level of profitability.**  |
| Chi-Square | 19.331a |
| Df | 3 |
| Asymp. Sig. | .000 |
| a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 33.3. |

Decision rule:

There researcher therefore reject the null hypothesis that state there is no effective working capital management in bank will improve level of profitability as the calculated value of 19.331 is greater than the critical value of 7.82

Therefore the alternate hypothesis is accepted that state there is effective working capital management in bank will improve level of profitability.

**TEST OF HYPOTHESIS TWO**

There is no relationship between adequate working capital and bank profitability

Table V

|  |
| --- |
| **there is no relationship between adequate working capital and bank profitability**  |
| Response  | Observed N | Expected N | Residual |
| Yes | 73 | 44.3 | 28.7 |
| No | 33 | 44.3 | -11.3 |
| Undecided | 27 | 44.3 | -17.3 |
| Total | 133 |  |  |

|  |
| --- |
| **Test Statistics** |
|  | there is no relationship between adequate working capital and bank profitability  |
| Chi-Square | 28.21 1a |
| Df | 2 |
| Asymp. Sig. | .000 |
| a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 44.3. |

Decision rule:

There researcher therefore reject the null hypothesis that state there is no relationship between adequate working capital and bank profitability as the calculated value of 28.211 is greater than the critical value of 5.99

Therefore the alternate hypothesis is accepted that state that there is relationship between adequate working capital and bank profitability

**CHAPTER FIVE**

**SUMMARY, CONCLUSION AND RECOMMENDATION**

**5.1 Introduction**

It is important to ascertain that the objective of this study was impact of adequate working capital on profitability of banks. In the preceding chapter, the relevant data collected for this study were presented, critically analyzed and appropriate interpretation given. In this chapter, certain recommendations made which in the opinion of the researcher will be of benefits in addressing the challenges of adequate working capital on profitability of banks

* 1. **Summary**

This study was on impact of adequate working capital on profitability of banks. Three objectives were raised which included: To ascertain the effective working capital management in bank will improve level of profitability, to ascertain the relationship between adequate working capital and bank profitability, to ascertain the impact of adequate working capital on profitability of bank. In line with these objectives, two research hypotheses were formulated and two null hypotheses were posited. The total population for the study is 200 staff of wema bank, Apata, Ibadan. The researcher used questionnaires as the instrument for the data collection. Descriptive Survey research design was adopted for this study. A total of 133 respondents made human resource managers, accountants, ICT analysts and senior staff were used for the study. The data collected were presented in tables and analyzed using simple percentages and frequencies

 **5.3 Conclusion**

 Understanding the fact that a number of studies have been conducted on working capital management theory and practice in the non-financial institutions, this study however aimed at contributing to existing literature on working capital management by extending it to financial institutions; that is the Nigerian Deposits Money Banks. The study undertakes to ascertain the relationship between working capital management and the profitability of DMBs in Nigeria. The study results depict positive relationship between Returns on Equity (ROE), Returns on Assets (ROA) and the elements of working capital management.

* 1. **Recommendation**

Wema bank should improve their marketing strategies so as to increase their sales and generate more profits for the bank. Given that loans are a major asset to the bank, we recommend the bank to increase their stringent measures while granting loans which will enable them to recover a larger proportion of loans they grant on their total loans. Wema bank can effectively manage their working capital to enhance profitability by putting in place adequate planning and controls to help them monitor their daily operations thereby maximizing shareholder wealth. We will also recommend them to invest more on profit generating activities only so as to increase income as well as their reserves. With these high reserves, they will be able to face any risk or crisis efficiently

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**QUESTIONNAIRE**

**INSTRUCTION**

Please tick or fill in where necessary as the case may be.

Section A

1. Gender of respondent

A male { }

B female { }

1. Age distribution of respondents
2. 15-20 { }
3. 21-30 { }
4. 31-40 { }
5. 41-50 { }
6. 51 and above { }
7. Marital status of respondents?
8. married [ ]
9. single [ ]
10. divorce [ ]
11. Educational qualification off respondents
12. SSCE/OND { }
13. HND/BSC { }
14. PGD/MSC { }
15. PHD { }

Others……………………………….

1. How long have you been in wema bank?
2. 0-2 years { }
3. 3-5 years { }
4. 6-11 years { }
5. 11 years and above……….
6. Position held by the respondent in wema bank
7. HRM { }
8. Accountant { }
9. ICT analyst { }
10. Senior staff { }
11. How long have you been in wema bank
12. 0-2 years { }
13. 3-5 years { }
14. 6-11 years { }
15. 11 years and above……….

SECTION B

1. Wema bank is one of the best banks in Nigeria?
2. Agrees { }
3. Strongly agreed { }
4. Disagreed { }
5. Strongly disagreed { }
6. There is impact of adequate working capital on profitability of bank?

(a) Agrees { }

(b) Strongly agreed { }

(c) Disagreed { }

(d) Strongly disagreed { }

1. There is no capital management in wema bank
2. Agreed { }
3. Strongly agreed { }
4. Disagreed { }
5. Strongly disagreed { }
6. There is no relationship between working capital and profitability
7. Agreed { }
8. Strongly agreed { }
9. Disagreed { }
10. Strongly disagreed { }
11. There is nothing like inventory management in wema bank
12. Agreed { }
13. Strongly agreed { }
14. Disagreed { }
15. Strongly disagreed { }
16. There is no relationship between liquidity and profitability
17. Agreed { }
18. Strongly agreed { }
19. Disagreed { }
20. Strongly disagreed { }
21. Wema bank have the best staff
22. Agreed { }
23. Strongly agreed { }
24. Disagreed { }
25. Strongly disagreed { }
26. There is measurement of profitability in wema bank
27. Agreed { }
28. Strongly agreed { }
29. Disagreed { }
30. Strongly disagreed { }
31. The cash conversion cycle has no significant impact on the profitability of the Nigerian banks
32. Agreed { }
33. Strongly agreed { }
34. Disagreed { }
35. Strongly disagreed { }