CHAPTER ONE

INTRODUCTION

1.1 Background of the Study:

In this era of globalization, the economic activities are soarig up in the international market. Nepal doesn't have its own long history of the economic activities. About two century ago the barter system was prevailing every where in the country, even now in the remote areas the system is still in practice. Until the period of reunification of modern Nepal by Prithvi Naryan Shah there were only two prevailing which was some how controlled by the Rnanas, their regime begun in 1903 B.S. During the beginning period of their regime, office like Tejarath Adda and Mulukhi Khana were established in order to attract deposits and grand loans. But it was not sufficient for the economic development due to lacking of experienced manpower and new technology. As the time passed by there some increasing economic activities was seemed in the country which led to the establishment of first commercial bank of Nepal viz. Nepal Bank Limited.

Thus, the history of the development of financial institutions in Nepal is not very long. Nepal bank Ltd. is the first commercial bank of Nepal, which was established in 1994 B.S. in non-government sector. The second commercial bank is Rastrya Bank Ltd., which was established in 2022B.S.in 100% government ownership. But after studying to the origin of modern banking, we come to know that "Bank DERIALO" which was established in 1587 A.D. is the first bank of the world in Venice, Italy.

Financial Institution can be considered as the catalyst to the economic growth of a country. The development process of a country involves the mobilization and developed of resources. Development of trade, commerce and industry are the prime requisite for the attainment of the economic political and social goals. To fulfill the purpose of planning, financial functions more often dominate the other functions. “ There is always lack of finance in underdeveloped economy because natural resources are either underutilized or unutilized in productive sectors or even other purposes i.e.; social welfare and so on. Likewise, underdeveloped countries are not deficient in land, water, mineral, forest or power resources, though they may be untapped; constituting only potential resources.” (Dewett; 1995:454) So in these countries for the rapid development of the economy, there should be proper mobilization of resources. Due to various difficulties or even ignorance of the people, such resources have not been properly utilized. Hoarding could be one of the reasons for this. So, banks and other financial institutions play a vital role to encourage thrift and discourage hoardings by mobilizing the resources and removing the habit of hoarding. They pursue rapid economics growth, developing the banking habit among the people, collecting the small-scattered resources in one bulk and utilizing them in further productive purposes and rendering other valuable services to the country. Thus,

This gives the individuals an opportunity to borrow funds against future income, which may improve the economic well being of the borrower.

Financial Institution in the economy plays a crucial role in the process of economic growth of the country. Financial institution refers to a business concern that is mainly confined to finance for the development of the trade, commerce and industry. Trade, commerce and industry are the prime factors of the economic development. Bank is a financial institution, which primarily deals in borrowing and lending. Banking is a vital part of national economy and a vehicle for the mobilization of economy’s financial resources and extension of credit to the business and service enterprises.

Commercial banks are the heart of the financial system. They hold the deposits of individuals, government establishment and business units. They make funds available through their lending and investing activities to borrowers: individuals, business firms and government establishments. In doing so, they assist both the flow of goods and services from the producers to consumers and the financial activities of the government. They provide a large portion of medium of exchange and they are the media through which monetary policy is affected. These facts show that the commercial banking system of a nation is very important to the functioning of its economy.

The concept of financial institutions in Nepal was introduced when the first commercial bank, Nepal Bank Limited (NBL) was established in Kartik 30, 1994 B.S. as a semi-government organization. In Baisakh 14, 2013 B.S. the first central bank, named as the Nepal Rastra Bank was established with an objective of supervising, protecting and directing the functions of commercial banking activities. Consequently, another commercial bank fully owned by the government, named as Rastriya Banijya Bank was established in 2022 B.S. under the Banijya Bank Act 2021 B.S. In the fiscal year 2039/40, new banking policy was introduced for the established for the establishment of new banks by the joint investment of foreign nations. Its objective was to create healthy competitive banking system and to provide cheap banking facilities to the people. The establishment of joint venture banks gave a new horizon to the financial sector of the country. Nepal Arab Bank Limited (NABIL) is the first joint venture commercial bank incorporated in 2041 B.S. In 2043 B.S., the second JVBS, Nepal Indosuez Bank Ltd (Currently Nepal Investment Bank Limited) was established. In the same year, Nepal Grindlays Bank Ltd. (Currently Standard Chartered Bank Nepal Limited) in the form of JVB was also established. But more JVBS came into existence after the initiation of government's policy of economic liberalization and privatization in 2049 B.S. They are Himalayan Bank Ltd. (2049), Nepal SBI Bank Ltd. (2050), Nepal Bangladesh Bank Ltd. (2051), Everest Bank Ltd. (2051) and Bank of Kathmandu (2052) came into existence in chronological order. Under favorable environment, various other banks were established thereafter.

In a global prospective, joint ventures are the mode of trading through partnership among nations and also a form of negotiations between various groups and services for sharing comparative advantages. A joint venture is the joining of forces between two or more enterprises for the purpose of carrying out a special operation (industrial or commercial investment, production or trade). These JVBS came into existence to accelerate the pace of economic development and financial system of the nation.

Proper financial decision making is extremely important in banking transaction for its efficiency and profitability. Most of the financial decisions of a bank are concerned with current assets and current liabilities. The working capital management of a bank is different from other types of business enterprises. A bank plays a significant role to fulfill the requirement of working capital of other type of business enterprise. It also needs to fulfill the requirement of working capital of other type of business enterprise. It also needs to efficiently manage its own working capital. Investment in working capital of other business enterprises is a part of current assets of bank's working capital and we can consider deposits and short-term borrowings as a part of current liabilities.

1.1.1 Introduction of Standard chartered Bank Nepal Limited:

The bank was originally established as a joint venture of Grindlays Bank PLC and Nepal Bank Limited 50 percent, Nepal Bank Limited 33.34 percent and general public 16.66 percent along with the change of ownership to standard Charted, the banking are of SCBNL saw the rise of a new dawn changing the general image of the bank. With this acquisition, Standard Chartered Bank now owns 50 percent share of Nepal Grindlays Bank Limited (NGBL) previously owned by ANZ Grindlays.

With the mission statement "To be the leading international bank in our principal markets", the bank operates through 11 offices, spread throughout Nepal and focuses mainly one corporate, consumer and commercial banking, providing services for international firms as well. The bank contributed to a large extent in the development of the country by the way of loans to industrial projects, the priority and deprived sectors.

Standard Chartered Bank Nepal Limited, offers a full range of banking products and services in wholesale and consumer banking, catering to wide range of customers from individuals, to mid-market local corporate to multinationals and public sector companies as well as embassies, aid agencies, airlines, hotels and government corporations.

The bank has been the pioneer in introducing ‘customer focused’ products and services in the country and aspires to continue to be a leader in introducing new products and highest level of service delivery. It is the first bank in Nepal that has implemented the Anti – Money Laundering Policy and applied the ‘Know Your Customer’ procedure on all the customer accounts.

The bank has 351 staff as of the 16th July 2007. This indicates that the bank provides very good working environment to the best of financial sector in the country great emphasis is put on training staff. To improve the skills and knowledge of the staff the bank continues to provide development programs in-house training programs, including on-the-job training and job rotation.

1.1.2 Introduction of Himalayan Bank Limited:

Himalayan Bank Limited was incorporated in 1992 by a few distinguished business personalities of Nepal in partnership with Employees Provident Fund and Habib Bank Limited, one of the largest commercial bank of Pakistan. Banking operation concerned from January 1993. It is the first commercial bank of Nepal whose maximum shares are held by the Nepalese private sector. Besides commercial banking services, the bank also offers industrial and merchant banking services.

The bank has six branches in Kathmandu Valley at the following location: Thamel, Newroad, Maharajgunj, Teku, Pulchowk (Patan) and Suryavinayak (moved from Nagarkot). In addition, the bank also has ten other branches outside Kathmandu Valley in Banepa, Tandi, Bharatpur, Birgunj, Hetauda, Biratnagar, Pokhara, Dharan, Siddharthanagar and Butwal.

Himalayan Bank has always been committed to providing a quality service to its valued customers with a personal touch. All customers are treated with utmost courtesy as valued clients. The bank wherever possible offers tailor made facilities to its clients, based on the unique needs and requirements of different clients. To further extend the reliable and efficient serviced to its valued customers, Himalayan Bank has adopted the latest banking technology. This has not only helped the bank to constantly improve its service level but has also prepared the bank for further adaptation to new technology. The bank already offers unique services such as SMS banking and Internet banking to customers and will be introducing more services like these in the near future.

Himalayan Bank is committed to be a bank where “Banking is done with a difference”.

1.2 Statement of the Problems:

Working capital is a crucial capital, which is compared as lifeblood of the human beings for any organization. In most enterprises the management of working capital has been misunderstood as the management of money rather that it’s efficient utilization. The management of working capital is synonymous to the management to short term liquidity. It has been regarded as one of the conditioning factor in the decision making issues. It is no doubt, very difficult to point out as to how much working capital is needed by a particular business organization. An organization, which is not willing to take more financial risks, can go for more short-term liquidity. The more of short term liquidity means more of current assets and less of current liabilities. The less current liabilities implies less short term financing heading to the lower returns resulting from the use of more high cost long term financing. So it is very essential to analyze and find out problems and its solution to make efficient use of funds for minimizing the risk of loss to attain profit objective.

Joint Venture banks like Standard Chartered Bank Nepal Limited and Himalayan Bank Limited are playing an important role in the economic development of the country. Wrong decision on working capital management of these two commercial banks not only affects the liquidity and profitability of the bank but also economy and banking system of the country.

Working capital management on bank is also difficult as that of manufacturing and non-manufacturing business organization. Commercial banks are great monetary institutions, which are playing important role to the general welfare of the economy. The responsibilities of commercial banks are more than any other financial institutions. They must be ready to pay on demand a good share of their liabilities without warning or notice. Bank collects fund from different types of deposits for providing loan and advances to different sector. To get higher return, banks must try to increase funds from deposits as well as their investment. The first motive of banking business is to borrow public saving and lend to needy people. But commercial banks always face the problem for utilizing more deposits as investment fully and productively. The gap between collection of deposits and disbursement of loans increase the cash balance on bank, which require paying its large amount of liabilities on its depositors demand without notice. But large amount of idle cash balance also decrease profitability of banks.

As mentioned above, following are the major problems that have been identified for the purpose of this study.

- How to utilize the liquidity in SCBNL and HBL?
- What is the management attitude towards risk?
- How to build the image of Bank through working capital management?
- Which of the current assets are more problematic in SCBNL and HBL?
- What lending pattern of loan and advances and other investment will be profitable?
- What components of working capital that affect the operating income of SCBNL and HBL?

1.3 Objectives of the Study:

The main objective of this study is to highlight and examine the management of working capital in Standard Chartered Bank Nepal Limited and Himalayan Bank Limited. The specific objectives of this study are as follows:

- To analyze the comparative study of working capital management of SCBNL and HBL.

- To examine and evaluate the position of current assets and current liabilities, and their impact on liquidity Position.
- To analyze composition of working capital, assets utilization and profitability.
- To provide recommendation and suggestions on the basis of major findings.

1.4 Significance of the Study:

Nepalese commercial banks are operating in the competitive environment. In this situation, banks have to adopt suitable strategies for their existence. They should balance and co-ordinate the different functional areas of business concern. The success or failure of any organization depends on its strategy, which is affected by working capital management. Working capital management is the crux of problem to prepare proper strategy on its favors.

The study has multidimensional significance, which can be divided into four broader headings.

1. Its significance to the shareholders: the study might be helpful to aware the shareholders regarding the working capital Management, i.e., liquidity and profitability of their banks. The comparison will help them to identify the productivity of their funds in each of these two banks.
2. Its significance to the management: the study might be helpful to go deep into the matters as to why the working capital management of their banks is better (or worse) than their competitors.

3. Its significance to the outsiders: among outsiders, mainly the customers, financing agencies, stock exchanges and stock traders are interested in the performance of banks and the customers (both depositors and debtors) can identify to which bank they should go. The financial agencies can understand where there is more secured and, stock exchange, stockbrokers and stock traders can find out the relative worth of the stocks of each bank.
4. Its significance to the policy makers: policy makers here refer to the government and Nepal Rastra Bank. The study will be helpful to them while formulating the policy regarding commercial banks.

Therefore, considering all these facts, the study of working capital management of SCBNL and HBL is considerably important.

1.5 Limitations of the Study:

The scope of the present study has been limited in terms of period of study as well as sources and nature of data. The period covered by the study extends over 5 years from 2003/04 to 2007/08 At the time of study; the data could be available up to 2007/08 only. The limitations of this study are as follows:

1) This study has been confined to only two of the joint venture banks, namely SCBNL and HBL.
2) The study is mainly based on secondary data. It is done mostly on the basis of the published financial documents, like balance sheet, profit and loss account and other related journals, magazines and books etc.

3) The study follows with specific tools such as ratio analysis, mean, CV, correlation, and hypothesis.

4) The lack of sufficient time and resources is another limitation of the study. The study is fully based on the student's financial resources and is to be completed within limited time. The report has taken only 5-year data for study from year 2003/04 to 2007/8

5) The study is limited from the point of view of submission on partial fulfillment of the requirement for the master degree in business study.

1.6 Organization of the Study:

This study has been divided into five chapters. They are as follows:

Chapter one is the introductory which deals with background of the study, profile of SCBNL and HBL, statement of problems, objective of the study, need of the study and limitations of the study.

The second chapter deals with the review of literatures relating to concept of working capital management, types of working capital, working capital policy, determinant of working capital, need of working capital, financing of working capital, review of books, review of journals/articles and review of dissertation.

The third chapter is the research methodology, which deals with research design, nature and sources of data, population and sample, period covered, data gathering procedure and tools of data analysis. For the analysis, various financial and statistical tools have been used which are discussed in details in this third chapter.

The fourth chapter deals with the presentation and analysis of relevant data and information through a definite course of research design. The chapter also presents the results relating to working capital management.

The latest chapter is concerned with the summary of the study. Various conclusions are drawn from the study and recommendations are provided for improving the future performance.

CHAPTER TWO

REVIEW OF LITERATURE

2.1 Introduction:

This chapter deals with the theoretical aspect of the topic on investment policy in more detail and descriptive manner. It provides the foundation for developing comprehensive theoretical framework and knowledge of the status relevant to the field of research in order to explore the relevant and true facts for the reporting purpose. Hence, in this chapter, the focus has been made on the review of literature relevant to the investment policy of commercial banks. For this study, different books, journals, articles, annual reports and some research paper related with this topic has been reviewed. For this purpose, chapter has been mainly sections, viz. theoretical perspective and review of related studies.

2.2 Concept of Working Capital Management:

Financial management is mainly concerned with two aspects. Firstly, fixed assets and fixed liabilities, or in other words, long term investment and sources of funds, and secondly, current uses and sources of funds. Both of these types of funds play a vital role in business finance.

Working capital refers to the resources of firm that are used to conduct operations to do day-to-day work that makes the business successful. Without cash, bills cannot be paid, without receivables; the firm cannot

allow timing difference between delivering goods or services and collecting the money to pay for them. Without inventories the firm cannot engage in production nor can it stock goods to provide immediate deliveries. As a result of the critical nature of current assets, the management of working capital in one of the most important areas in determining whether a firm will be successful. The term working capital refers to the current assets of the firm-those items that can be converted into cash within the year. Hence, working capital management is the management for the short-term. It is a process of short-term operation of an enterprise. It is a process of planning and controlling the level of mix of current assets of the firm as well as financing these assets. It concludes decision regarding cash and marketable securities, receivables, inventories and current liabilities with an objective of maximizing the overall value of a firm.
According to I.M. Pandey, there are two concepts of working capital:

Gross working capital: It is simply called as working capital, refers to the firm's investment in current assets. Current assets are the assets which can be converted into cash within an accounting year (or operating cycle) and include cash, marketable securities, inventory, account receivable and debtors.

Net working capital: This is of critical importance to a firm. Net working capital refers to the difference between current assets and current liabilities. Current liabilities are those claims of outsiders that are expected to mature for payment within an accounting year and include creditors (account payable) bills payable and outstanding expenses. (Pandey, I.M. 1995:730)

Another way of defining working capital is that portion of firm's current assets financed with long term fund. Both liquid assets and liabilities are important in working capital management.

Net working capital can be positive or negative. A positive net working capital will arise when current assets exceed current liabilities. A negative net working capital occurs when current liabilities are in excess of current assets.

2.3 Types of Working Capital:

There are two types of working capital: Permanent working capital and variable working capital. These working capital are necessary for any organization for continuous production and sales without any interruption.

i. Permanent (Fixed) Working Capital:

Permanent working capital refers to that level of current assets, which is required on a continuous basis over the entire year. A manufacturing concern cannot operate regular production and sales functions in the absence of this portion of working capital. Therefore, a manufacturing concern holds certain minimum amount of working capital to ensure uninterrupted production and sales functions. This portion of working capital is directly related to the firm's expansion of operation capacity.

ii. Variable working capital:

Variable working capital represents that portion of working capital, which is required over permanent working capital. If the nature of production and sales of a firm is directly related to seasonal variations, it should stock extra raw materials, working in progress and inventory of finished goods. Therefore, this portion of working capital depends upon the nature of firm's production relation between labor and management.

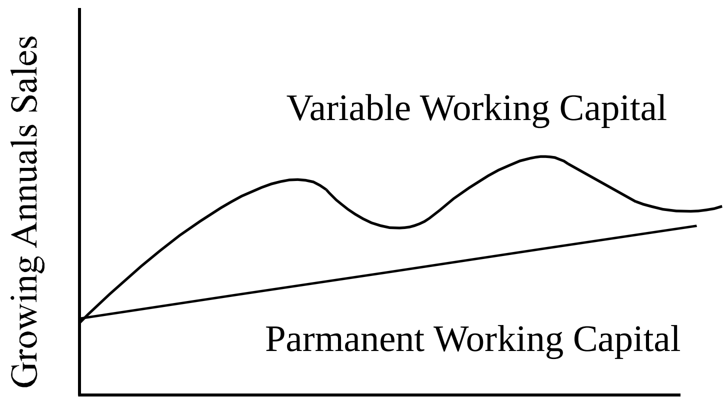

Figure 2.1 Types of Working Capitals

Figure 2.1 (I. M. Pandey :1992:808) Shows clearly about this portion of working capital. If an firm has sound management on this portion of working capital, it can easily win over other competitors in today's competitive and aggressive market.

2.4 Working Capital Policy:

Working capital policy refers to the firm's basics policies regarding target levels for each category of current assets and how current assets will be financed.(Western, J. Fred. : 1996:343) So first of all, in working capital management, a firm has to determine how much funds should be invested in working capital in gross concept. Every firm can adopt different financing policy according to financial manager's attitude towards the risk-return trade off. One of the most important decisions is financing current assets. Any firm has working capital policies regarding to the level of each category of current assets and their financing are discussed in the ensuing part of this section.

i. Current Assets Investment Policy:

Current assets investment policy refers to the policy regarding the total amount of current assets to be carried to support the given level of sales. There are three alternative current assets investment polices, namely, Fact Cat, Lean & Mean and Moderate.

a. Fat Cat Policy:

This is also known as relaxed current assets investment policy. It is the policy under which relatively large amounts of cash and marketable securities and inventories are carried, and sales are stimulated by a liberal credit policy which results in high level of receivables. This also creates the longer receivable collection period. Thus this policy provides the low expected return in investment with lower risk.(western, J. Fred: 1996:344)

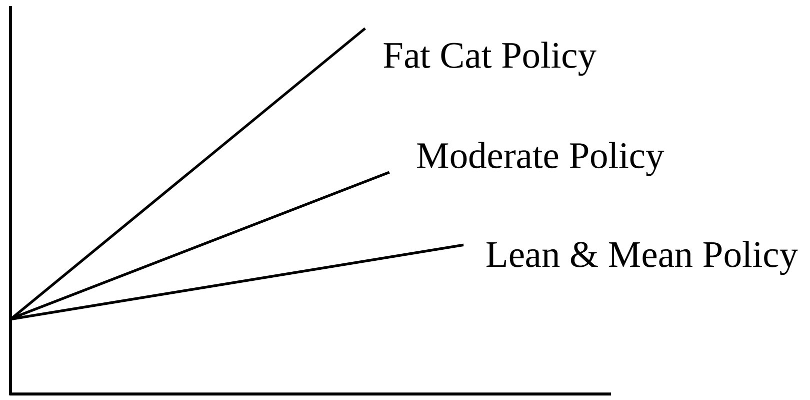

Figure 2.2 Alternative Current Assets Policies

b. Lean and Mean Policy:

This is also known as restricted current assets investment policy. This is the policy under which holding of cash and marketable securities, inventories and receivable are minimized. (J. Fred Western & Brigham, Eugene F.:1996:344) This policy tends to reduce the policy conversion and receivable conversion cycle. Under this policy firm follows a tight credit policy and bears the risk of losing sales.

c. Moderate Policy:

It id the policy that is between the relaxed and restrictive polices. In moderate policy, a firm holds the amount of current assets in between the relaxed and restrictive policies. Both risk and return are moderate in this policy.

ii. Current Assets Financing Policy

It is the manner in which the permanent and temporary current assets are financed. Current assets are financed with funds raised from different sources. But cost and risk affect the financing of any assets. Thus, current assets financing policy should clearly outline the sources of financing of currents. There are three variables, namely, aggressive, conservative and matching policies of current assets financing.

a. Aggressive Policy:

In aggressive policy, all the fixed assets of a firm are financed with long-term capital, but some of the firm's permanent assets are financed with short-term, non-spontaneous sources of fund.(J. Fred Weston & Brigham, Eugene f. :1996:348) In other words, the firm finances not only temporary current assets but also a part of permanent current assets with short-term financing. Figure 2.3 (J. Fred Weston & Brigham, Eugene F.: 1996:347) shows that 50% of the permanent current assets are financed through short-term financing. In general, interest rate increases with time, i.e., the shorter the time, lower the interest rate. It is because lenders are risk adverse and risk generally increases with the length of lending period. Thus, under normal circumstances, the firm borrows on a short-term financing rather than that from long-term financing. On the other side, if the firm finances its permanent current assets by short-term financing, then if runs the risk of renewing the borrowing again and again. This future interest expenses will fluctuate widely, and it may also be difficult for the firm to raise the fund during the stringent credit this policy. In conclusion, there is higher return and low liquidity position under this policy.

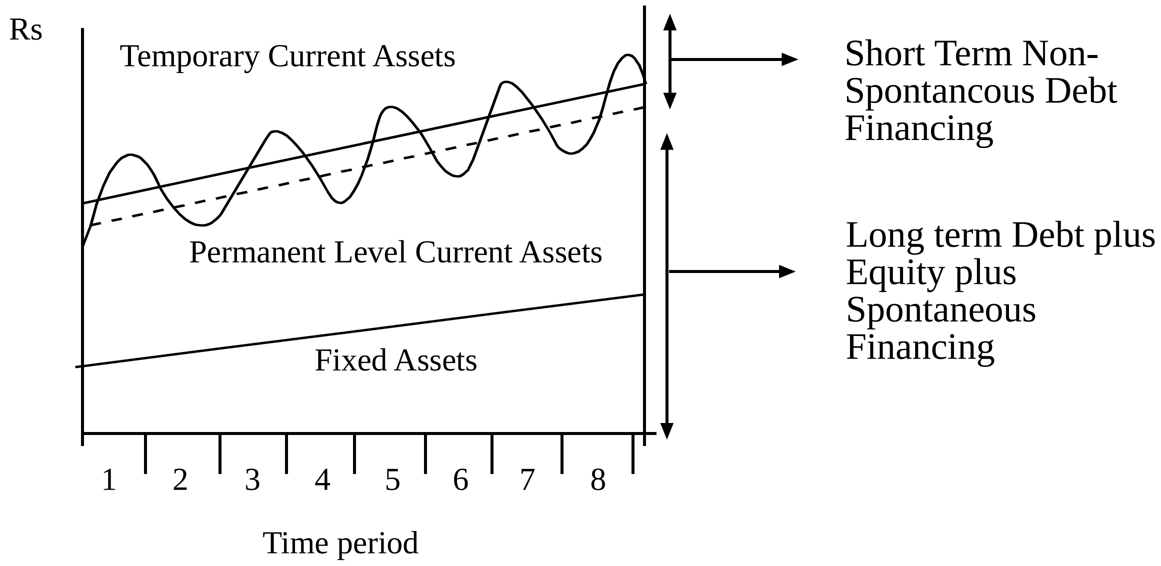

Figure 2.3: Aggressive financing policy.

b. Conservation policy:

In conservative policy, the firm uses long term financing to finance not only fixed assets and permanent current assets, but also part of temporary current assets i.e., with short term financing.(J. Fred Weston & Brigham, Eugene F.:1996:347) It means that the firm depends upon the long-term sources for financing needs. This policy leads to high level of current assets, with long conversion cycle, low level of current liabilities and higher interest cost. The risk and return are lower than that of aggressive one. The risk adverse management follows this policy.

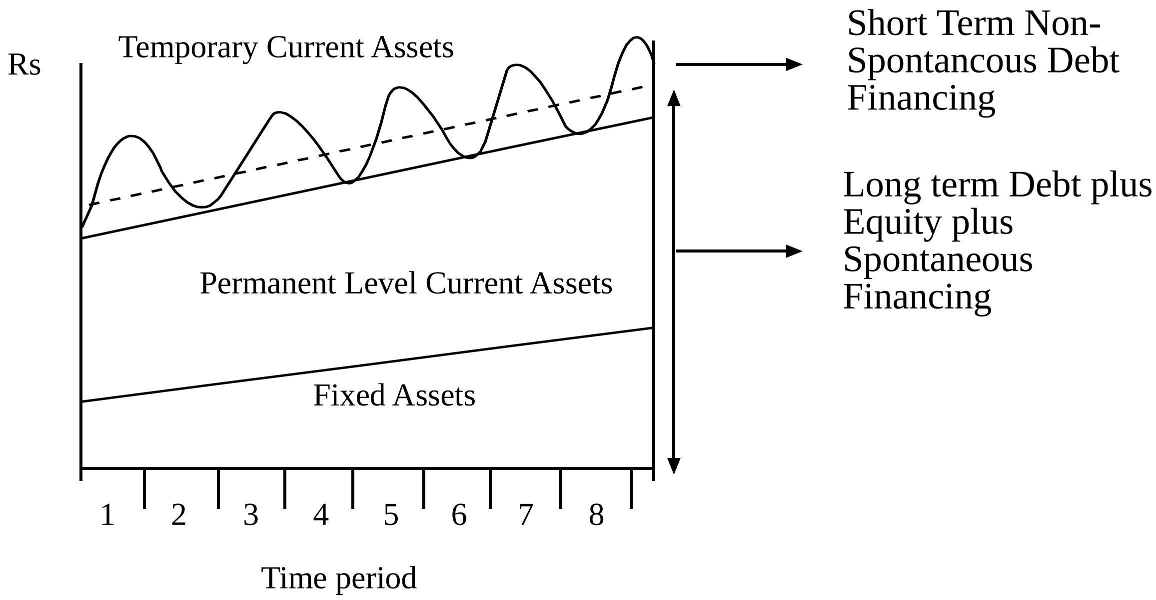

Figure 2.4: Conservative Financing Policy

c. Maturity Matching Policy:

It is self-liquidity approach. In this policy, the firm finances the permanent current assets with long-term financing and temporary with short-term financing. It means that the firm matches the maturity of financing source with an assets useful life. It lies in between the aggressive and conservation policies. It leads to both neither high nor low level if current assets and current liabilities. It lies in between a low profitability. Figure 2.5 (J. Fred Weston & Brigham, Eugene F.:1996:348) shows the temporary working capital is financed by short-term financing and long-term financing. Thus, no working capital is financed by long-term funds. Hence, net working capital is zero under this policy.

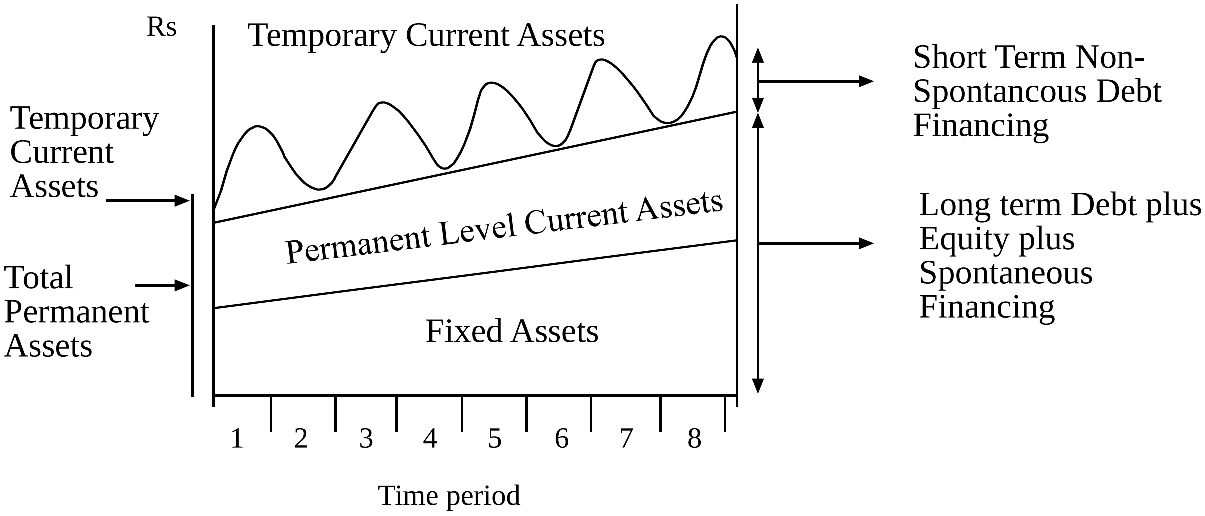

Figure 2.5 Maturity Matching Financing Policy

2.5 Determinants of Working Capital:

All the firms, whether public or private, manufacturing or non-manufacturing, must have adequate working capital to survive in competitive market. It should have neither too excess nor too inadequate working capital. But, there are no sets of rules or formulae to determine the working capital requirement of the firm. It is because of a large number of factors that influence the working capital requirement of the firm. A number of factors affect different firm in different ways. Internal policies and changes in environment also affect the working capital. Generally, the following factors affect the working capital requirement of the firm.

1. Nature and Size of Business:

It depends upon the nature and size of the business. If the size of the firm is bigger, than it requires more working capital. While a small firm needs less working capital. Trading and financial firm require larger amount of working capital relatively to public utilities, while manufacturing concern lies between these two extremes.

2. **Growth and Expansion:**

This also affects the working capital requirement of a firm. A growing firm needs more working capital than those static ones. However, it is difficult to precisely determine the relationship between the growth and expansion of the firm and working capital needs.

3. **Credit Policy:**

Working capital requirement depends on terms of sales. Different terms may be followed to different customers according to their credit worthiness. If the firm follows the liberal credit policy then it requires more working capital. Conversely, if firm follows the stringent credit policy, it requires less working capital.

4. **Production Policy:**

If a firm produces seasonal goods, then it sells its products in a certain month of the year. In this situation, it can either confine its production only that period when goods are sold or follow a steady production policy through the year and produce goods at level to meet the peak demand. The former policy does not need more working capital than the latter does.

5. **Availability of credit:**

Availability of credit facility is another factor that affects the working capital requirement. If the creditors avail a liberal credit terms then the firm will need less working capital and vice-versa. In Other Words, if the firm can get credit facility easily on favorable conditions, it requires less working capital to run the firm smoothly otherwise more working capital is required to operate the firm smoothly.

6. **Manufacturing cycle:**

Working capital requirement of an enterprise is also influenced by the manufacturing or production cycle. It refers to the time involved to make the finished goods from the raw materials. During the process of manufacturing cycle, the larger will be working capital requirement and vice-versa.

7. **Profit Margin:**

The level of profit margin differs from firm to firm. It depends upon the nature and quality of product, marketing management and monopoly power in the market. If the firm deals with the high quality product, has a sound marketing management and has enjoyed monopoly power in the market then if earns quite high profit and vice-versa. Profit is sources of working capital pool by generating more internal funds.

8. **Price Level Change:**

Generally, a firm is required to maintain the higher amount of working capital if the price level rises, because the same level of current assets needs more funds due to the increasing price. In conclusion, the implications of changing price level on working capital position will vary from firm to firm depending on the nature and other relevant consideration of the operation of the concerned firms.

9. **Operating Efficiency:**

It is also the important factor, which influence the working capital requirement of the firm. It refers to the efficient utilization of available resources at minimum cost. Thus, financing manager can contribute to strong working capital position though operating efficiency. If a firm has strong operating efficiency then it needs less amount of working capital otherwise if requires large amount of working capital.

10. Level of Taxes:

The level of taxes also influences working capital requirement. The amount of taxes to be paid advance is determined by prevailing tax regulations. But the firm's profit is not constant or can't be predetermined. Tax liability in a sense of short-term liquidity is payable in cash. Therefore, the provision for tax amount is one of the important aspects of working capital planning. If tax liability increases, it needs to increase the working capital and vice versa.

2.6 Need for Working Capital:

Working capital is the effective lifeblood and controlling nerve center of every business organization because without the proper control upon it, no business organization can run smoothly. Thus, it plays a crucial role in the success and failure of the organization. The need for working capital to run the day-to-day business activates cannot be overemphasized. We will hardly find a business firm which does not require any amount of working capital. Indeed, firms differ in their requirements of the working capital. We know that firms aim at maximizing the wealth of shareholders. In its endeavor to do so, a firm should earn sufficient return from its operation. The extent to which profit can be earned naturally depends upon the magnitude of sales among the other things. For constant operation of business, every firm needs to hold the working capital components, cash, receivable, inventory etc, therefore, every firm needs working capital to meet the following motivates:

i. **Transaction motive:**

Transaction motive require a firm to hold cash and inventories to facilities smooth production and sales operations in regular. Thus, the firm needs working capital to meet the transaction motive

ii. **Precautionary motive:**

Precautionary motivation is the need to hold cash and inventories to guard against the risk of the unpredictable change in demand and supply forces and other factors such as strike, failure of important customers, unexpected slow down in collection of account receivable, cancellation of some other order for goods and some other unexpected emergency. Thus, the firm needs the working capital to meet contingencies in future.

iii. **Speculative motive:**

It refers to the desire of a firm to take advantage of the opportunities like opportunities of profit making investment, an opportunity of purchasing raw material at a reduced price on payment of immediate cash, to speculate on interest rate, and to make purchases at favorable price etc. Thus the firm needs the working capital to meet the speculative motive.

2.7 Financing of working capital:

Every manufacturing concern or industry requires additional assets whether they are in stable or growing conditions. When the growing firm wants to generate sustained normally require fixed capital as well as working capital. Additional portion of working capital is approximately dominated by the same rate as sales. But this portion of capital requirement depends up on the nature of the firm. So the most important function of financed manager is to determine the level of working capital and to decide how it is to be finance. Financing of any assets is concerned with two major factors- cost and risk. Therefore the financial manager must determine an appropriate financing mix or decide how current liabilities should be used to finance current assets. However, a number of financing mixes are available to the financial manager. He can present generally three kinds of financing.

1. **Long Term financing:**

   Long term financing has high liquidity and low profitability. Ordinary share, debenture, preference share, retained earning and long-term debts from financial institution are the major sources of long-term financing. Even it includes retained earnings and long-term loan from Nepal development corporation and long-term other commercial bank.

2. **Short Term Financing:**

   Firm must arrange short-term credit in advance. The sources of short-term financing of working capital are trade credit and bank borrowing.

i. Trade Credit:

It refers to the credit that a customer gets from supplies of goods in the normal course of business. The buying firms does not pay cash immediately for the purchase is called trade credit. It is mostly an informal arrangement and granted on an open account basis. Another form of trade credit is bills payable. It depends upon the term of trade credit.

ii. Bank Credit:

Bank credit is the primary institutional sources for working capital financing. For the purpose of bank credit, amount of working capital requirement has to be estimated by the borrowers and banks are approached with the necessary supporting data. Bank determines the maximum credit based on the margin requirements of the security. The following types of loan are provided by commercial banks.

a. Loan Arrangement:

Under this arrangement the entire amount of loan is given credit by the bank to the borrowers account, and the loan is repaid in installments, interest is payables on actual balance outstanding.

b. Overdraft Arrangement:

Under this arrangement the borrowers is allowed to overdraw on this current account with the bank up to stipulate limit. Within this limit, any numbers of drawings are permitted. Repayment should be made in short period.

c. Commercial Papers:

It is used only by well-established high quality companies. This evidence of debts is an unsecured short-term promissory note sold in the money market. It is sold either though dealers or directly to inventories. Besides the above form of credit, bank provider loan against the warehouse receipt, inventory receivable. In our contest, most popular sources of short term financing are short-term loan from public deposit, which is also a major source of working capital financing in our country.

3. **Spontaneous Financing:**

Spontaneous financing arises from the normal operation of the firms. The two major sources of such financing are trade credit (i.e., credit and bills payable) and accruals. Whether trade credit is free of cost or not actually depends upon the terms of trade credit. Financial manager of the firm would like to finance its working capital with spontaneous sources as much as possible. In practical aspect, the real choice of current assets financing is either short-term or long-term sources. Thus, the financial manager concentrates his power in short –term versus long-term financing. Hence, the financing of working capital depends upon the working capital policy, which is perfectly dominated by the management attitude to wards the risk-return.

2.8 Significance of Working Capital Management:

The management of working capital is important for several for several reasons. For one thing, the current assets of a typical manufacturing firm account for over half of its total assets. For a distribution company, they account for even more. Excessive levels of current assets can easily result in a firm realizing a substandard return on investment. However, firms with too few current assets may incur shortages and difficulties in maintaining smooth operations.

For small companies, current liabilities are the principal source of external financing. These firms do not have access to the longer term capital markets, other than to acquire a mortgage on a building. The fast-growing but larger company also market use of current liability financing. For these reasons, the financial manager and staff devote a considerable portion of their time to working capital matters. The management of cash, marketable securities, account receivable, account payable, accruals, and other means of short term financing is the direct responsibility of the financial manager; only the management of inventories is not. Moreover, these management responsibilities require continuous, day-to-day supervision. Unlike dividend and capital structure decisions, we cannot study the issue, reach a decision, and set the matter aside for many months to come. Thus, working capital management is important, if for no other reason than the proportion of the financial manager’s time that must be devoted to it. More fundamental, however, is the effect that working capital decisions have on the company's risk, return, and share price. (Van Horne & Wachowicz: 1999:204)

Profitability and Risk

Underlying sound working capital management lie two fundamental decision issues for the firm. They are the determination of;

- The optimal level of investment in current assets
- The appropriate mix of short-term and long-term financing used to support this investment in current assets.

In turn, these decisions are influenced by the trade-off that must be made between profitability and risk. Lowering the level of investment in current assets, while still being able to support sales, would lead to an increase in the firm's return on total assets. To the extent that the explicit costs of short-term financing are less than those of intermediate and long-term financing, the greater the proportion of short-term debt to total debt, the higher is the profitability of the firm.

Although short-term interest rates sometimes exceed long-term rates, generally they are less. Even when short-term rates are higher, the situation is likely to be only temporary. Over an extended period of time, we would expect to pay more in interest cost with long-term debt than we would with short-term borrowings, which are continually rolled over (refinanced) at maturity. Moreover, the use of short-term debt as opposed to longer term debt is likely to result in higher profits because debt will be paid off during periods when it is not needed.

These profitability assumptions suggest maintaining a low level of current assets and high proportion of current liabilities to total liabilities.

This strategy will result in a low, or conceivably negative, level of net working capital. Offsetting the profitability of this strategy, however, is the increased risk to the firm. Here, risk means jeopardy to the firm for not maintaining sufficient current assets to.

- Meet its cash obligations as they occur.
- Support the proper level of sales (e.g., running out of inventory). (Van Horne & Wachowicz; 1999:204-205)

2.9 Review of Books:

Some of the books on financial management regarding working capital management are reviewed here under.

The well-known professors ***Weston and Brigham*** (J. Fred Weston & Eugene F. Brigham: 7th edition) have given some theoretical insights into working capital management after their various research studies on it. The bond conceptual finding's of their study provides sound knowledge and guidance for the further study on the field of management of working capital in any enterprise and naturally to this study as well. They explain, in the beginning. The importance of working capital, concept of working capital, financing of working capital, the use of short term Vs long term debt, relationship of current assets to fixed assets. In the next chapter they have dealt with the various components of working capitals and their effective management techniques. The components of working capital they have dealt with are- cash, marketable securities, receivable and inventory. For the efficient management of cash, they have explained the different cash management models. They have also explained the major sources and forms of short term financing such as trade credit, loans from commercial banks and commercial paper.

Van Horn (James C. Van Horn " Financial Management and Policy" New Delhi) has categorized the various components of working capital i.e. liquidity, receivable and inventory and current liabilities and grouping them according to the way they affect valuation. He has also described the different methods for efficient management of cash and marketable securities and various models for balancing cash and marketable securities. For the management of receivable, different credit and collection policies have been described and various principles of inventory have been examined for inventory management and control.

For the working capital management, a well- known Indian professor ***I.M. Pandey*** (I.M. Pandey, "Financial Management" New Delhi) has described some conceptual ingredients, which are base on his various research studies. He has described various aspects of working capital management. He has divided working capital management into five chapters. The first chapter deals with the concepts of working capital, need for working capital, determinants of working capital, dimension of working capital management, optimum level of current assets, and working capital trends in India. In the second chapter, he has described the management of cash and marketable securities, where he has dealt with facts of cash management, motives for holding cash, cash planning, managing the cash flows, determining the optimum cash balance, investment in marketable securities. In the third chapter, he has described the management of receivable, in which he has dealt with goals of credit management, optimum credit policy, aspects of credit policy, credit procedures for individual accounts. In the fourth chapter on inventory management, he has described the need to hold inventories, objectives of inventory management, inventory management techniques, selective inventory control technique and financial manager's role in inventory management. For financing of working capital has described the Tondon Committee recommendation on the fifth chapter.

Dr. Radhey Shyam Pradhan (Dr. Radhey Shyam Pradhan 1986, “Management of working capital” New Delhi) has published a book on management of working capital in Nepalese PEs. This book is based on the study on none manufacturing public enterprises of Nepal for the duration of ten years from 1973 to 1982 A.D. He has aimed to provide useful insight into the existing and forthcoming corporations on working capital behavior. In this study, he has dealt with various issues viz- type of working capital policy followed by those PEs- liquidity positions, structure of working capital, nature of working capital, utilization and demand for working capital and its various components with changes volume of sales in those PEs. In the study he reveals that most of the selected enterprises achieved a trade off between risk and return there- by following neither an aggressive nor a conservative approach. Almost all the selected PEs had a positive net working capital and much of the growth in net working capital might, however, be attributed to inflation as the froth in net working capital at deflated prices has been much lower. The liquidity measures showed a poor liquidity position in majority of MPEs. It has been noticed that the enterprises had either negative cash flows or earning before tax or they had excessive net current debts, which could not be paid within a year. Of the current assets, which is o an average, half of the total assets in PEs,. The share of inventories is the largest followed by receivables and cash. There had been an improvement in utilization of current assets in the majority of PEs. He also noticed that the adjustment speed of actual to desire balance had been observed as highest for cash followed by inventories. However the speed of adjustment was much slower in all this cases. The results were, therefore, surprising as the adjustment of even cash holding was not immediate. Further more, the inclusion of capacity utilization in the models did not seem to have contributed much to the demand functions of working capital and its various components. Thus, capacity utilization as a significant variable affecting these demand functions was doubtful. This book, thus, provides an extensive and comprehensive survey on the overall liquidity position, working capital policy, working capital utilization and demand functions of the current assets.

Suniti Shrestha (Suniti Shrestha 1995 “Portfolio Behavior of Commercial Banks in Nepal”) study on portfolio behavior of commercial banks in Nepal and selected two local commercial banks, three joint – venture banks and one development banks a sample for the study. Some major findings of her study are here under

- Total deposits have been the major sources of fund for all the banks.
- Capital and reserve funds do not seem to have changed much over the year.
- The user of fund analysis show that the resources of commercial banks are allocated in the liquid funds, investments on securities, loans and advances, bills purchased and discounted.
- Among the portfolio, for Nepalese banks loan and advances share highest volume of the resources and the bills purchased and discounted the least over the year.
- The excess reserves of the commercial banks show unused resource. The cash reserve exceeds much more than the required cash reserve.

2.10 Review of Articles:

This section deals with the review of journal/ articles and research work by different management experts relating to working capital management and bank performance.

Narayan Pd. Paudel's (Narayan Pd. Paudel 2053 B.S. "Financial Statement Analysis: An Approach to Evaluate Bank's Performance" Nepal Rastra Bank samachar) article described the necessity and importance of financial statement analysis to evaluate bank's performance. Analysis of bank financial statement is different from other companies due to special nature of assets and liabilities structure of the banking industry. The bank's balance sheet is composed of financial claims a liability in the form of deposits and as assets in the form of loans but fixed asset account for a small portion of the total assets. He described the major balance sheet characteristics of commercial banks which are as follows:

Characteristics	Significance	Risk	Return
1) Few Fixed Assets	Low degree of operating leverage	Reduce	Reduce
2) Substantial amount of short term liabilities (Deposits)	To be liquid	Increase	Increase
3) Substantial amount of Financial Assets	High degree of operating leverage	Increase	Increase

At last, he added that analysis of Financial Statements can give a good insight a good insight into financial health and performance of a bank.

Dr. Manohar K. Shrestha, (Dr. Manohar K. Shrestha, July 1992 –june 1983 "Working Capital Management in Public Enterprises: A study on Financial Results and Constraints" ISDOC Vol.8) in his article has considered ten selected PEs and studied the working capital management in those PEs. He has focused on the liquidity, turnover and profitability position of those enterprises. He found that four PEs had maintained adequate liquidity position two had excessive and remaining four had had failed to maintain desirable liquidity position. On the turnover, four had adequate turnover, one had high turnover and remaining three had not satisfactory turnover on net working capital. He had also fount that out of ten PEs, six PEs were operating at losses while only four were getting some percentage f profits. With reference to those findings he had brought certain policy issues such as lack of suitable financial planning negligence of working capital management, deviation between liquidity and turnover of assets and inability to show positive relationship between turnover and return on net working capital.

Dr. K. Acharya (Dr. K. Acharya, 1985 "Problems & Impediment in the Mangement of Working Capital In Nepalese Enterprises" ISDOC Vol. 10) articles has described the two major problems: operational problems and organizational problems regarding the working capital management in Nepalese PEs. The operational problems he found are listed in the current ratio 2:1 and slow turnover of inventory. Similarly, change in working capital in relation to fixed capital had very low impacts over the profitability, thin transmutation of capital employed to sales, absent of apathetic management information system; break even analysis, fund flow analysis and ratio analysis were either undone or ineffective for performance evaluation. Finally monitoring of the proper functioning of working capital management has never been considered a managerial job. In the second part, he has listed the organizational problems in the PEs. In most of the PEs, there is lack of regular internal and external audit system as well as evaluation of financial results. Similarly, very few PEs have been able to present their capital requirement, functioning of finance department is not satisfactory and some PEs are even facing the under-utilization of capacity. To make an efficient use of fund for minimizing the risk of loss and to attain profit objective, he has made some suggestions.

2.11 Review of Previous Thesis:

Various research works have done by MBA and MBS students in different aspects of commercial banking, such as financing performance, working capital management etc. studies and reviews on working capital management of other organizations and their conclusion are relevant to my study. Some reviewed previous dissertations are as follows:

Arjun Lal Joshi has studied on the topic " A study on working capital management of Birat Nagar Jute Mill Ltd." (1986). The main objective of this study is to show the composition of working capital and relationship between working capital and working capital components. To fulfill these objectives, he has taken five-year study period and used secondary data. He found out that inventory, cash and bank balance, receivable and components of working capital. The major portion of current assets has been occupied by inventory and cash, which have not been efficiently managed. The company has relied heavily on bank support for meeting additional funds without making the best utilization of realized funds. Receivable turnover is in favourable condition. Collection period is also favourable. It means the company can change in cash in very short period.

The major findings of the study were:

-Inventory held major share of current assets followed by debtors and very negligible cash balance.

-The company held poor liquidity position and was financed by short term sources (short term bank credit).

-The company had not earned sufficient profit even to pay the interest on short term loans.

Pradeep Kumar Pathak has done a research on "An Evaluation of working capital management of Nepal Lube Oil Limited." (1994). The main objective of his study is to appraise the working capital management of NLOL and to study the relationship between sales and different variables of working capital. To achieve these objectives, he has taken five-year study period and applied the secondary data.

He found out the current assets with respect to total assets are in increasing trend year after year during the study period. It has occupied high portion than fixed assets. Investment on current assets has affected on investment on total assets. According to him, the growing tendency of investment over current assets could have adverse effects In NLOL's wealth maximization goal in the long run.

According to the conclusion of his study, the major findings were:

- The company had lesser participation of fixed assets in total assets.

- Cash holds of the company was relatively small portion of total assets and inventory held largest portion indicating unsound inventory management.
- The company was inefficient in collecting receivables.
- Receivables were not affected by sales.
- Current assets did not depend upon the volume of cash and receivables however significance relation between proportion of current assets and total asset, current asset and fixed asset, current assets and current liabilities and quick asset and current liability was.

Miss Rojina Shrestha has carried out a study, her study "A study on Working capital management with respect to National Trading Limited and Salt Trading Corporation Limited (2003)." Her main objective is to present overall picture of working capital of National Trading Limited and Salt Trading Corporation Limited. The major findings of the study are as follows:

- The Current Assets to Total Assets of NTL and STCL both are in fluctuating trend.
- The investment in current assets is high in both of the trading companies with respect to its total assets and net fixed assets.
- Cash and bank balance holds the highest portion followed by inventory in NTL whereas cash and bank balance holds the least portion in STCL and inventory holds the highest portion.
- The turnover position of the NTL and STCL are in fluctuating trend.
- The liquidity position of the STCL is satisfactory and favorable in comparison to the liquidity position of the NTL.

Similarly, Mr. Dikpal Subedi has carried out a study " Working Capital Management of Manufacturing Companies Listed in NEPSE (2003)." His main objective is to examine the working capital policy of Nepalese manufacturing companies listed m Nepal Stock Exchange Limited. He has identified the following points as major findings:-

- There is wide variation of the current assets within individual manufacturing companies.
- The ratio of cash to current assets is widely varied among manufacturing companies during the study period from 1997 to 2001.
- The overall company average of receivable to current assets ratio is 16 percentages.
- There is wide variation in the ratio of inventory to current assets among the manufacturing companies.
- There is no consistency in the company average of current assets to total assets in manufacturing companies.
- The liquidity position of Nepalese manufacturing companies is not similar among different companies.

Mr. Basudev Shrestha has carried out his research on "A study on working capital management of Dairy Development Corporation (2001)". The main objective of the study is to analyze the current assets and current liabilities and their impact and relationship to each other. The major findings of his study are as follows:

- The major components of current assets in DDC are inventory cash and bank balance, sundry debtors and miscellaneous current assets in which inventory hold the major portion respectively in each year.
- The company's investment in the form of working capital has been increasing, The average investment in current assets is lower with respect to net fixed assets during the study period and DDC has no clear vision about the investment in current assets to fixed assets Portion.

- The average receivable turnover and ACP is in fluctuating trend during the study period.
- There is ineffective liquidity position and unsatisfactory profitability ratio in DDC.
- The overall return position of DDC is negative i.e. not in favorable condition. It is because of inefficient utilization of CA, TA and shareholders' wealth.

Mr. Subash Chandra Shrestha has carried out "A comparative study of working capital management in Bhaktapur Brick Factory and Harishiddh, Factory (1992)". His main objective is to focus on the components of working capital cash, inventory receivable and current liabilities. He had done comparative assumed of WCM of BBF and HBF. He had used financial ratios as a major tool of analysis. In addition of this, he had used mean, index, standard deviation and coefficient of variation. The major findings of his study are as follows:

- There is no proper relationship between liquidity and profitability of two brick factories.
- Both Brick factories have followed various working capitals. There is no good combination between fixed capital and working capital.
- BBF has been seriously suffered from negative return whereas HBF has generated positive return. However, both factories profitability position is not satisfactory.
- Overall management and working capital is not strong in both brick factories.

Niraj K.C., has conducted research on “Comparative study of working Capital management of Nepal Bank Limited and Nepal Arab Bank Limited (2000).”

The major objectives of the research are:-

- To review the related literature of recent development in working capital management.
- To analyses the comparative study of working capital management of NBL and NABIL.
- To study the current asset and current liabilities and their impact and relationship to each other of NBL and NABIL.

Based on his findings, he has recommended that NBL should reduce or replace fixed deposits by collecting higher amount of short term deposits. NBL as well as NABIL should give proper attention on collection of over-dated loan and advances and utilization of idle fund as loan and advances. NBL should reduce its cost through reducing high cost deposit, and operate in a proper way so that it can have least operating cost which further maximize its profitability and maximize shareholders return. Both banks should adopt the matching working capital management policy instead of adopting conservative working capital policy.

The major findings of his study were:

- The major components of current assets in NBL and NABIL are cash, hank balance, loan advances and government securities.
- Out of the major three current assets components, cash and bank balance holds the smallest portion in NBL. On the other hand, government securities hold the smallest portion in NABIL. The interest income of NBL was better than NABIL.
- The trend of quick ratio, cash and bank balance to deposit ratio, and cash and bank balance to deposit ratio, and cash and bank balance to current, margin and other deposit ratios of NBL and NABIL are decreasing. The liquidity position of NBL was always better than NABIL.

- Fixed deposit to total deposit, ratios of NBL were always higher than same of NABIL for the study period.
- The turnover positions of NBL are in fluctuating trend but turnover positions of NABIL are decreasing in first three years then increasing in last two years of study period. NABIL has the better utilization of deposits in income generating activity than NBL. Also the NABIL has better investment efficiency on loan and advance.
- Large portion of long term debt is used in current assets of both banks but relatively it is higher on NBL than NABIL. Both banks follow conservative working capital policy but NBL has more conservative working capital than NABIL. Due to more conservative working capital policy, risk of insolvency is lesser but cost of fund is higher on NBL than NABIL.
- The profitability position of NABIL is far better although NBL earned higher interest NABIL.

Hari Prasad Lamsal, has conducted research study on “A comparative study of working capital management of NABIL and Standard Chartered Bank Nepal Limited (2004).” The main objectives are:-

- To study the current assets and current liabilities and their impact on liquidity and profitability.
- To analyze the liquidity, assets utilization, long term solvency and profitability of both banks.
- To analyze the comparative study of working capital management between NABIL and SCBNL.

Based on his findings, the Standard Chartered should seriously adjust its policy of investment on loan and advances with collected funds and increase their proportion of loan and advances in total current assets. Fixed deposits and saving deposits turnover position are also not satisfactory on both banks. Therefore, NABIL as well as SCBNIL should give proper attention on collection over dated loan and advances and utilization of idle fund as well as loan and advances. Interest earned to total assets ratio is higher cost on NABIL but net profit ratios are less then SCBNL. It is due to higher cost on NABIL. By adopting the matching working capital management policy instead of adopting conservative working capital policy NABIL as well as SCBNL could improve in its profitability in the short run as well as long run.

The major findings of his study were:

- The major components of current assets in NABIL and SCBNL are cash and bank balance, loan and advance and government securities.
- The liquidity position of SCBNL is better than NABIL.
- The turnover position of NABIL has better than SCBNL. The NABIL has better utilization of deposits in income generating activity than SCBNL.
- Long term debt to net worth ratio of NABIL is always higher than SCBNL on that study period.
- Net profit to total assets ratio and net profit to total deposit ratios are always higher on SCBNL than NABIL. Cost of services to total assets ratio of NABIL is always higher than the same of SCBNL

on the study period. The average value of interest earned to total assets ratio of NABIL is higher than SCBNL.

2.12 Research Gap

Many research studies have been conducted by the different students, experts and researchers about working capital management. There have been found numerous research studies on financial companies and public enterprises regarding working capital. Some studies are related to a case study of a single company and some others are comparative in nature. But the comparative study of working capital management between two financial companies can be hardly found. From the review of related studies no one study have been found (working capital management) as a comparative study in the context of Standard Chartered Bank Nepal Limited (SCBNL) and Himalayan Bank Limited (HBL). The financial and statistical tools used by most of the researchers were ratio analysis, test of hypothesis and regression analysis. This research includes different tools like ratio analysis, correlation analysis and trend analysis as specific tools.

This research study made on “A comparative study of working capital management of Standard Chartered Bank Nepal Limited and Himalayan Bank Limited” will be an effort to analyze on detail about working capital management of the two banks as a comparative study in present situation with the help of various related financial as well as statistical tools and techniques. The study can be beneficial to all the concerned parties like investors, policy makers, and student to carry on further studies.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

Research methodology is a way to systematically solve the research problem. It refers to the various sequential steps that are to be adopted by a researcher during the course of studying the problem with certain objectives. This chapter refers to the overall research method from the theoretical aspects to the collection and analysis of data. This study covers quantitative methodology in a greater extent and also uses the descriptive part based on both technical aspects and logical aspect. This research tries to perform a well-designed quatative and qualitative research in a very clear and direct way using both financial and statistical tools.

3.2 Research Design

This study aims to portray accurately upon the working capital (or current assets and current liabilities) and its impact on overall financial position of two banks under consideration, namely, SCBNL and HBL Bank. The research methodology followed for this study is basically descriptive cum analytical research design.

3.3 Population and Sample

Nowadays a number of commercial banks have been emerging rapidly. Some have already been established and others are in the process of establishment. Currently, there are 25 commercial banks in Nepal. In this study, all the commercial banks are population of the study. Among them SCBNL and HBL have been selected as samples for the present study on the basis good financial performance.

3.4 Nature and Sources of Data

The data used in this study are secondary in nature. Published annual reports of the concerned banks are taken as basic source of data. The data relating to financial performance are directly obtained from the concerned banks. Similarly, related books, magazines, journals, articles, reports, bulletins, data from Nepal Stock Exchange and Nepal Rastra Bank, Central Bureau of statistics, related website from internet etc. as well as other supplementary data and various economic surveys are also used. Previous related studies to the subject are also counted as source of information.

3.5 Data Gathering Procedure

Since the data have been obtained from secondary sources, after collection of financial statement, master sheet of financial data have been extracted and tabulated as per the need of this study. In order to process the data, financial statement and other available information were reviewed. These data were grouped in different tables and charts according to their nature. Most of the data have been compiled in one form and processed and interpreted as required.

3.6 Tools of Data Analysis

Financial as well as the statistical tools are used to make the analysis more convenient, reliable and authentic. For data analysis, different items from the balance sheet and other statements are tabulated. Their ratios, percentages, mean, standard deviations, and coefficients of variations are then calculated and presented in the tables. To study the relationship between two or more variables, correlation coefficients are also calculated. In order to know about the sources and applications of the fund, funds flow statement is prepared. Likewise, trend analysis is also used to know the trend of various ratios. Following are the brief introductions of the financial and statistical tools used in this study.

3.6.1 Financial Tools

Financial ratios are calculated to ascertain the financial condition of the firm. It is the relationship between financial variables contained in the financial statements (i.e., balance sheet, profit and loss account and income statements). It helps the related parties to spot out the financial strength and weakness of the firm. There are several financial tools, which can be applied in order to analyze the performance of commercial banks. The financial tools used in this study are as follows: Liquidity Ratio, Activity Ratio, and Profitability Ratio. Similarly, net working capital and composition of working capital in terms of cash and bank balance percentage, loan and advances percentage government securities percentage and miscellaneous current assets percentage are also calculated.

I. Liquidity Ratio

This ratio measures the liquidity position and short-term solvency of the firm indicating the company's ability to meet short-term obligation. The current ratio and quick ratio measure the liquidity position of the company. (Pradhan; 2000:53) These ratios are calculated to judge the long term as well as short-term financial position of concerned firm. Liquidity of any business organization is directly related to working capital or current assets and current liabilities of that organization. One of the main objectives of working capital management is keeping good liquidity position. Commercial banks need liquidity to meet loan demand and deposit withdrawals. Without good liquidity, bank is not able to operate its' function. To measure the bank's solvency position or ability to meet its short term obligation, various liquidity ratios are calculated.

The liquidity ratios calculated in this study are as follows:

a. Current Ratio

Current Ratio reflects the strength of current assets available with the company over its current liabilities into cash in one accounting year. This ratio indicates the current short term solvency position of the bank. The current ratios are the ratios of total current assets to current liabilities. Higher current ratio indicates better liquidity position. In other words, current ratio represents a margin of safety. The higher the current ratio, the greater the margin of safety, and the larger the amount of current assets in relation to current liabilities, the more the bank's ability to meet its current obligations. By definition,

$$\textbf{Current Ratio}\ \mathrm{X}\frac{\textbf{Current Assets}}{\textbf{Current Liabilities}}$$

b. Quick Ratio

Quick ratio is used to measure the ability of concerned firms to pay current obligation (Short term) without depending on other liquid assets of current ratio. It provides relationship between quick assets with current liabilities. An asset is liquid if it can be converted into cash immediately or reasonably soon without a loss of value. Cash is the most liquid asset. Other assets that are considered to be relatively liquid and included in quick assets are book debts and marketable securities. This quick ratio can be found out by dividing the total quick assets by total liabilities.

$$\textbf{Quick Ratio}\ \mathrm{X}\frac{\textbf{Quick or Liquid Assets}}{\textbf{Current Liabilities}}$$

c. Cash and Bank Balance to Deposit Ratio (Excluding Fixed Deposit)

This ratio shows the ability of banks immediate funds to cover their (Current margin, call and saving) deposits. It can be calculated by dividing cash and bank balance by deposits (excluding fixed deposits). The ratio can be expressed as:

$$\textbf{Balance to Deposit Ratio}\ \mathrm{X}\frac{\textbf{Cash and Bank Balance}}{\textbf{Total Deposit (Excluding Fix Deposit)}}$$

Moreover, Nepal Rastra Bank “Directory” provision of 5% of cash balance with NRB to total deposit is to be maintained.

d. Fixed Deposit to Total Deposit Ratio

Fixed deposit is a long term and high interest charge bearing deposit. Although a high cost liability, increasing fixed deposits is subject to an additional advantage if utilized properly. Sufficient fixed deposits enable banks to grant long term loan to their clients at higher interest rate. This ratio is calculated in order to find out the proportion of total deposit that has higher interest charge bearing. The higher the ratio, the more the interest bearing deposits as well as better liquidity and lower proportion of current or short term deposits. It is computed by dividing the amount of fixed deposits by the total deposits amount which is expressed as follows:

$$\textbf{Fixed Deposit to Total Deposit Ratio}\ \mathrm{X}\frac{\textbf{Fixed Deposits}}{\textbf{Total Deposits}}$$

e. Savings Deposit to Total Deposit Ratio

Saving deposit is an interest bearing short term deposit. The ratio is developed in order to find out the proportion of saving deposit, which is interest bearing and short term in nature. It calculated by dividing the total amount of savings deposits by the amount of total deposits that can be expressed as follows:

$$\textbf{Saving Deposit to Total Deposit Ratio}\ \mathrm{X}\frac{\textbf{Savings Deposits}}{\textbf{Total Deposits}}$$

II. Activity or Turnover Ratio

The funds of creditors and owners are invested in various assets to generate sales and profit. Activity ratios are used to evaluate the efficiency with which the firm manages and utilizes its assets. This ratio indicates how quickly certain assets are converted into cash. From this ratio it can be known whether or not the business activities are efficient. These ratios are also called turnover ratios because they indicate speed with which assets are converted or turnover into profit generating assets. These ratios, moreover, help in measuring the banks' ability to utilize their available resources. Following ratios are used under the activity ratios.

a. Loans & Advances to Total Deposit Ratio

The ratio assesses to what extent the bankers are able to utilize the depositors' fund to earn profit by providing loans and advances. In other words, how quickly total collected deposits are converted into loans and advances given to the client to earn income. It is computed by dividing the total amount of loan and advances to total deposit fund. Higher ratio indicates higher/proper utilization of funds and low ratio is the signal of inefficiency or remaining idle.

$$\textbf{Loans \& Advances to Total Deposit Ratio}\ \mathrm{X}\frac{\textbf{Loan \& Advances}}{\textbf{Total Deposits}}$$

b. Loan & Advances to Fixed Deposit Ratio

This ratio differs slightly from the former one because it includes the fixed deposits only. The ratio measures how many much amount is used in loans and advances in comparison to fixed deposits. Fixed deposits are interest bearing long term obligations where as loan and advances are the major sources of investment in generating income for commercial banks. It is calculated as follows:

$$\textbf{Loans \& Advances to Fixed Deposit Ratio}\ \mathrm{X}\frac{\textbf{Loan \& Advances}}{\textbf{Fixed Deposits}}$$

c. Loan & Advances to Savings Deposit Ratio

This ratio is also employed for the purpose of measuring utilization of savings deposits in generating revenue by giving loan and advances to the client i.e., to determine to what extent collected saving deposit amount is being deployed in providing loan and advances to generate income. Saving deposits are interest bearing obligation for short term purpose whereas loan and advances are the short term investment for revenue income. This ratio indicates how much short term interest bearing deposits are utilized for income generating purpose. The formula for this ratio is as follows:

$$\textbf{Loans \& Advances to Savings Deposit Ratio}\ \mathrm{X}\frac{\textbf{Loan \& Advances}}{\textbf{Savings Deposits}}$$

III. Profitability Ratio

The profitability ratio, as the name suggests, measures the operating profitability in terms of profit margin return on equity and return on total investment, and reflects the overall efficiency and effectiveness of management. (Pradhan; 2000:53). Shareholders, bankers, government, tax collectors, employees are concerned with the profitability of the company; the shareholders are interested with their rate of return, employees in the future prospect of the company, government in companies' tax payment capacity and bankers in the perspective of the company. A required level of profit is necessary for survival and growth of a firm in a competitive environment.

Profitability can be measured in terms of a relationship between net profit and assets. This ratio is also known as profit-to-asset ratio. It measures the profitability of investment.

Various ratios can be developed based upon the profit under different circumstances. These different ratios are called profitability ratios, which are required to support the purpose of the study. The profitability ratios calculated in this study are:

a. Interest Earned to Total Assets Ratio

This ratio is used to determine total interest earned from investments over the total assets of a firm. It can be computed as follows:

$$\textbf{Interest Earned to Total Assets Ratio}\ \mathrm{X}\frac{\textbf{Interest Earned}}{\textbf{Total Assets}}$$

b. Net Profit to Total Assets Ratio:

Profit to total asset ratio is useful in measuring the profitability of all financial resources invested compared to total assets of a firm. This ratio is calculated by dividing the amount of net profit by the amount of total assets employed. Hence,

$$\textbf{Net Profit to Total Assets Ratio}\ \mathrm{X}\frac{\textbf{Net Profit}}{\textbf{Total Assets}}$$

c. Net Profit to Total Deposit Ratio

This ratio measures the percentage of profit earned from the utilization of the total deposits. Deposits are mobilized for investment, loan and advances to the public in generating revenue. Higher ratio indicates the return from investment on loans and lower ratio indicates that the funds are not properly mobilized.

$$\textbf{Net Profit to Total Deposit Ratio}\ \mathrm{X}\frac{\textbf{Net Profit}}{\textbf{Total Deposit}}$$

d. Cost of Services to Total Assets Ratio

A sound management always tries to utilize its larger amount of assets with minimum cost. Cost of services to total assets ratio is useful in measuring the utilization of assets with cost of services. The ratio can be expressed as:

$$\textbf{Cost of Service to Total Assets Ratio}\ \mathrm{X}\frac{\textbf{Cost of Services}}{\textbf{Total Assets}}$$

IV. Composition of Working Capital

To operate a business, different kinds of assets are needed. For the day-to-day business operation, different types of current assets are utilized. In case of SCBNL and HBL, the main components of current assets are cash and bank balance, loan and advances and government securities. Miscellaneous current assets are also a component of current assets. Prepaid expenses, outstanding income like interest receivable and other current assets are included in miscellaneous current assets.

In this study, composition percentages of following components:

- Cash and bank balance percentage

- Loan and advances percentage
- Government securities percentage
- Miscellaneous current assets percentage

V. Net Working Capital

Net working capital is the difference between current assets and current liabilities. Net working capital can be positive or negative. A positive net working capital will arise when current assets exceed current liabilities. A negative net working capital occurs when current liabilities are in excess of current assets.

3.6.2 Statistical Tools

Various financial tools mentioned above were used to analyze the working capital management of SCBNL and HBL. Likewise, the relationship between different variables related to the study topics were also drawn out using statistical tools.

a. Mean or Average

The mean or average value is a single value within the range of the data that is used to represent all the values in the series. Since an average is somewhere within the range of the data, it is also called a measure of central value. Average value is obtained by adding together all the terms and by dividing this total by the number of items. The formula is given below:

$$\overline{X} = \frac{X}{N}$$

= Arithmetic Average

x = Sum of values of all terms, and,

N = Number of terms

b. Standard Deviation

The standard deviation is the measure that is most often used to describe variability in data distributions. It can be thought of as a rough measure of the average amount by which observations deviate on either side of the mean. Denoted by Greek letter ± (read as sigma), standard deviation is extremely useful for judging the representatives of the mean. Standard deviation is represented as:

$$\pm \ X\sqrt{\frac{d^2}{n\,Z1}}$$

Where,

∃ = Standard deviation,

d^2 = Sum of squares of the deviations measured from the arithmetic average, and,

n = Number of items

c. Coefficient of Variation

The coefficient of variation is the ratio of standard deviation to the mean for a given sample used to measure spread. It can also be thought of as the measure of relative risk. The larger the coefficient of variation, the greater-the risk relative to the average. Mathematically,

$$CV = \frac{\exists}{\overline{X}},$$

Where,

CV = Coefficient of variation,

∃ = Standard deviation, and,

$\overline{X}$ = Arithmetic Average

d. Coefficient of Correlation

Correlation is a statistical tool, which is used to describe the degree to which one variable is linearly related to another. The coefficient of correlation measures the degree of relationship between to sets of figures. Among the various methods of finding out coefficient of correlation, Karl Pearson's method is applied in the study. The result of coefficient of correlation is always between +1 and -1. When r, the coefficient o correlation is +1, there is perfect relationship between two variables and vice-versa. When r is 0, there is no relationship between two variables. The formula for the calculation of coefficient of correlation between X and Y is given below:

$$r \,\mathrm{X} \frac{XY}{\sqrt{\quad X^{2} \quad Y^{2}}}$$

Also the test of significance of correlation coefficient has been done in this study. In order to test whether the correlation coefficient is significant to the correlation between the two variables, paired sample t-test has been applied at the standard significance level of 5%. If calculated value of t is greater or equal to its tabulated value, correlation is significant or else it is not significant. The formula for the calculation of t value is,

$$t \,\mathrm{X} \frac{r\sqrt{n \,\mathrm{Z}\, 2}}{\sqrt{1 \,\mathrm{Z}\, r^{2}}}$$

e. Trend Analysis

Trend Analysis is an analysis of financial ratio over time used to determine the improvement of determination of its financial situation. The trend line is represented by following equation.

$Y_c = a + bx$, where

Y_c = 1 Estimated value of Y for given value of x in coordinate axes,

a = Y intercept of mean of Y value,

b = slope of the line or rate of change

x = variable in time axis

To find the values of a & b, we have to solve the following equations:

$$Y = N_a + b \quad X \qquad (1)$$

$$XY = a \quad X + b \quad X^2 \qquad (2)$$

Where, N = Number of years

To make calculation easier, the deviation of the independent variable (i.e. time) are taken from the middle of the time period so that IX=0, then the above two equation change to:

f. Test of Hypothesis

A hypothesis is a conjectural statement of the relation between two or more variables. Hypothesis is always in declarative sentence form and they relate either generally or specifically, variables to variables. There are two criteria for 'good' hypothesis and hypothesis statement. One hypothetical statement is about the relations between variables. Second hypothesis carries a clear implication for testing the stated relation. These criteria mean that hypothesis statement certain two or more variables that are measurable and they specify how are related.

As stated in chapter one, some conceptual frame work of null and alternative hypothesis between SCBNL and HBL in various variables are formulated and tested as follows:

For the study some set of null hypothesis have been formulated and tested.

a. H0: There is no significant difference in composition of working capital between SCBNL and HBL.

   H1: there is significant difference in composition of working capital between SCBNL and HBL.

b. H0: there is no significant difference in liquidity position between SCBNL and HBL.

   H1: there is significant difference m liquidity position between SCBNL and HBL.

c. H0: There is no significant difference in profitability position between SCBNL and HBL.

   H1: There is significant difference in profitability position between SCBNL and HBL.

To test the validity of our assumption, if sample size is less than 30, t-test is used. For applying t-test in the context of small sample, the t-value is calculated first and compared with the table value of t at a certain level of significance (say on 5%) for given degree of freedom. If calculated value of t exceeds the table value, we infer that the null hypothesis is rejected i.e., the difference is significance at 5% level of significance. But if t is less than the concerning table value of t, the null hypothesis is accepted i.e., the difference is not treated as significant.

3.7 Limitations of the Methodology

Each methodology suffers from some kind of limitations. Therefore, the methodology used in this research cannot be different from the common limitations of same type of researches. However, in analyzing working capital management of the selected sample, the tools applied cannot best describe the relationship between the variables under study since working capital management tools are based on various assumptions. Hence, the reliability, accuracy and validity of the research findings depend on this sample.

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APPENDIX-1
Calculation of Trend Value of Cash and Bank Balance to Current Assets Ratio:

X^2	SCBNL			HBL		
	Y_1	XY_1	Y_C=a+bx	Y_2	XY_2	Y_C=a+bx
4	15.24	-30.48	11.47	12.61	-25.22	7.44
1	18.05	-18.05	16.32	12.18	-12.81	9.85
0	15.45	0	14.94	11.51	0	12.25
1	12.68	12.68	16.68	11.76	11.76	14.66
4	13.30	53.2	18.41	12.58	50.32	17.06
ģx^2=10	**ģy_1=74.72**	**ģxy_1=17.35**		**ģy_2=61.27**	**ģxy_2=24.05**	

For SCBNL,

$$a X \frac{XY_1}{N} X \frac{74.72}{5} X14.94$$

$$b X \frac{XY_1}{X^2} X \frac{17.35}{10} X1.735$$

For HBL,

$$a X \frac{XY_2}{N} X \frac{61.27}{5} X12.25$$

$$b X \frac{XY_2}{X^2} X \frac{24.05}{10} X2.405$$

APPENDIX-2
Calculation of Trend Value of Loan and Advances to Current Assets Ratio:

X^2	SCBNL			HBL		
	Y_1	XY_1	Y_C=a+bx	Y_2	XY_2	Y_C=a+bx
4	27.39	-54.78	27.43	59.25	-118.5	60.72
1	27.28	-27.28	30.09	64.62	-64.62	61.07
0	37.34	0	32.76	58.26	0	61.41
1	34.82	34.82	37.49	63.24	63.24	61.75
4	36.95	73.90	38.09	61.66	123.32	62.10
ģx^2=10	**ģy_1=163.78**	**ģxy_1=26.66**		**ģy_2=307.03**	**ģxy_2=3.44**	

For SCBNL,

$$a X \frac{Y_1}{N} X \frac{163.78}{5} X32.76$$

$$b X \frac{XY_1}{X^2} X \frac{26.66}{10} X2.666$$

For HBL,

$$a X \frac{Y_2}{N} X \frac{307.03}{5} X61.41$$

$$b X \frac{XY_2}{X^2} X \frac{3.44}{10} X0.344$$