

# Effect of Aggressive & Conservative Working Capital Management Policy on Performance of Scheduled Commercial Banks of Pakistan

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## Abstract

This study examines the impact of working capital management and its policies (investment and financing) on the performance of the scheduled commercial banks listed in PSE (Pakistan Stock Exchange) for the time period of 2009-2013. The performance of the banking sector has been determined with return on asset (ROA), return on equity (ROE) and cash to cash equivalent (CCE). Working capital management has been measured with cash conversion cycle (CCC), current liabilities to total asset (CL/TA) and current asset to total asset (CA/TA). Financial leverage and size of the bank have been used as control variables. The results revealed from the selected 30 commercial banks as sample that there is a negative relationship between CA/TA, CL/TA and CCC with ROA and ROE. There is a significant positive relationship between CA/TA and CCE, however, its relationship with CL/TA and CCC is insignificant. The control variables show significant positive relationships with ROA and ROE and significant negative relationships with CCE. Whereas leverage shows insignificant relationship with ROA, ROE and CCE.

**Keywords:** Working Capital Management, scheduled commercial banks, aggressive working capital policy, conservative working capital policy.

## 1. INTRODUCTION

In financial management, the customary consideration has been given to the topics of short and long tenures financial decisions and obligations. Nevertheless, in balance sheet, current or short-term assets and short term liabilities are considered as essential constituents of overall assets and liabilities. The management of current assets and current liabilities refer to short term financing or working capital. The history of working capital originated with the old Yankee peddler, who would load his wagon with pots and pans and take off to peddle his wares. His horse and wagon were his fixed assets, while his merchandise was sold, or turned over at a profit, and thus was called his working capital (Brigham & Ehrhardt, 2011). It can be defined as: "It refers to the funds, which a company must possess to finance its day to day operations" (Bhat, 2008). The company's working capital management takes part in an imperative task in company's profitability and overall risk factors and lastly in companies value (Smith, 1980).

This concept is mostly applied to the non-financial sectors and its goal is to manage each of the firm's current assets (inventory, marketable securities, accounts receivable and cash) and current liabilities (accounts payable, accruals, and notes payable) to maximize the value of the firm in terms of profitability and liquidity (Gitman & Zutter, 2012). Current assets can be divided into two categories, operating and non-operating. Operating current assets consist of cash plus marketable securities held as a substitute for operating cash, inventories, and accounts receivable. These are assets that are necessary to operate the business. Non-operating current assets consist of any other current assets i.e. short-term securities, cash from the sale of a stock, bond or funds held in case the firm loses a lawsuit. This study attempts to apply the concept of working capital management with operating current assets because the operating current assets is a policy decision, which affects profitability (Brigham & Ehrhardt, 2011).

The investment in current assets can be financed through bank loans, credit from suppliers (accounts payable), accrued liabilities, long-term debt, and common equity. To manage the current asset with respect to its current liabilities, the working capital policies were developed i.e. investment and financing policies. The investment policy refers to the investment in current asset in relation to its total asset, more investments in current assets reflect conservativeness because companies put greater quantity of invested capital in highly liquid asset whereas lesser in current asset reflect aggressive strategy. The financing policy means the ratio of current liabilities with respect to current asset. The aggressive financing policy heavily relies on short-term financing whereas conservative strategy relies on long-term financing (Brigham & Ehrhardt, 2011; Gitman & Zutter, 2012).

Most of the authors believe that the concept of working capital lies in banking sector but many researchers conducted in Ghana, Srilanka and Nepal help to make an attempt to measure working capital which plays an important role in enhancing the profitability of a bank. The efficient way of managing the working capital of a bank may enhance its survival and promote healthier growth activities which directly affects the bank's solvency

and profitability measures. In Banks physical goods are not being made, they borrow and lend funds to their customers. The income of a bank is the difference between the interest income earned by lending out money to the public and the interest given on the deposit by the customers. The assets of bank based on cash and balances with treasury banks or other banks, advances and non-performing loan, provision against advances and lending to financial institutions. The equity of the bank ordinary share capital, reserve and un-appropriated profit or loss etc. (Annual Reports SBP). The banks do not have fixed assets, and they heavily rely on borrowing from customers in the form of deposits (Annual Reports SBP).

The main purpose of this study is to make an attempt to explore the impact of working capital policies and its management on the profitability and liquidity of banking sector of Pakistan. Previous literature explored the impact of working capital policies and its management on profitability on non-financial firms (Afza & Nazir, 2011; Ali & Ali, 2012; Nazir & Afza, 2009; Rehman & Anjum, 2013; ul Haq, Sohail, Zaman, & Alam, 2011; Zeeshan Khan, 2012). This study is an effort to attain guidance for the financial sector, especially the commercial banks of Pakistan and to maintain the optimal level of working capital which enhances its liquidity and profitability. (Gamlath & Rathirane, 2012; Samuel Kwaku Agyei & Benjamin Yeboah, 2011; Yeboah & Agyei, 2012).

### **Aggressive Policy**

The managers' desire to accomplish high earnings through bare minimum capital investment. In this scenario, permanent capital captivated in physical or financial assets that generate an inferior working capital ratio to Circulating Assets for the accounting period or fiscal year. To cover the shortage of working capital, the bank calls on short term debt financing. This strategy can be a risky choice because the businesses rely on the bank's pronouncement policy (credit terms and interest rate). Though, if bank's earnings ratio is superior to the interest rate, then working capital policy is satisfactory for the reason that it produces the affirmative result of obligation.

### **Conservative Policy**

It can be explained as when managers put high investment in Short Term assets or Current Assets as compared to Long Term or Fixed Assets. Conservativeness can also be defined as when organizations maintain high level of current liabilities to finance its short term and long term financial needs. Firm's profitability and value have been negatively affected by following a conservative investment policy and aggressive financing policy. Firm leverage has negative impact on the firm's profitability and value, whereas, firm Size and firm growth have a positive impact (Vahid, Mohsen, & Mohammadreza, 2012).

## **1.2. Research Question**

For a commercial bank it is very important to accurately identify which working capital management policy is to use. Whether, it is aggressive or conservative? What are the effects of these selected policies on the performance/profitability and liquidity of the commercial bank?

How to check the differences between working capital management and different working capital policies across various listed commercial banks in KSE in Pakistan with an effect on their performance/profitability and liquidity?

## **1.3. Objectives of the Study**

The study has the following specific objectives:

1. To investigate the impact of working capital investment policy and its effects on the performance of the scheduled commercial banks in Pakistan.
2. To explore the impact of working capital financing policy and its effects on the performance of the scheduled commercial banks in Pakistan.
3. To evaluate the Cash Conversion cycle and its effects on scheduled commercial bank's performance.
4. To assess the effects of firm size on the performance of the scheduled commercial bank.
5. To measure the effect of leverage on scheduled commercial bank's performance.

The Organization of the study is as follows; section II presents the literature review. In section III sources of data, detail of variables and hypothesis empirical methodology, have been discussed. In the end some expected results have been discussed.

## **2. LITERATURE REVIEW**

Various literature has been reviewed through research papers, articles, books and magazines, and it has given evidence, attributed to the management and significance of working capital, and found a familiar view regarding "Working Capital Management". So, the managers have found that there is an existence of some relationship between Working Capital Management and the profitability and liquidity of an organization.

Deloof M (2003) thrashed out, the method by which working capital is supervised might have substantial impact on company's profitability measures. There is a strong negative association among trade payable and company's profitability measures is steady with the idea that a lesser amount of profitability stays more to disburse their trade payables. Saghir, Hashmi, & Hussain (2011) revealed that there exists statistically strong negative

association among profitability measures, (Return on Asset proxy measure for profitability) and cash conversion cycle. There is a strong negative association among cash operating cycle, market valuation and performance measures as the leverage is positively related through companies' valuation and associated negatively with companies' performance measures (Sunday et al. 2012; Gardner et al. 1986; Weinraub & Visscher, 1998; Lazaridis I & D Tryfonidis, 2006; Soenen, 1993; Shin & Soenen, 1998). Rehman (2006) found that there exists a strong negative association among Working Capital Management ratios mentioned above and company's profitability. Moreover, corporate executives can generate a value for the shareowners by dipping the length of cash conversion cycle (CCC) up to the most advantageous level. Comparative researches on working capital and company profitability include (Smith & Beg & Tryfonidis, 2006).

Qazi et al. (2011) showed that the net working capital is positive and a strong significant relationship. The length of time increases in cash conversion cycle it will show the way to dilapidated in company's profitability measures and corporate executive be able to create a significant positive value for their shareowners through administration of sufficient cash operating cycle and maintaining all diverse components to the most favorable level. By shortening collection period of accounts receivable and cash conversion cycle, a firm can intensify its profitability measures by gross operating profit. The corporate executives can generate positive value by dipping their inventories level and the number of days account's outstanding. Consequently, there are significant relations between working capital management and firm performance (Vural, Sokmen, & Çete, 2012; Huynh Phuong Dong & Jyh-tay Su, 2010; Garcia-Teruel & Martinez-Solano, 2007; Singh and Pandey, 2008). Gill et al (2010) explored that there is a strong significant association among the cash operating cycle and company's profitability that is measured through gross operating margin.

Companies who have selected conservative policies are competent enough to boost up the profit via managing cash conversion cycle properly and, maintaining all special constituents of Working Capital that are trade receivables, days in payables and inventory level to the most favorable level. In contrast, following an aggressive financing strategy lays negative effects on the company's profitability measures and value maximization. Adina Elena Danulețiu (2010) attempted to explore the effectiveness of working capital of firms' from Alba County and results showed that most of companies applied an aggressive Policy for cash conversion cycle and least adopted conservative Policy. Nazir & Afza (2009) found that there exists a strong significant difference between working capital necessities and company's financing strategies crosswise divergent sectors. Additionally, pooled regression analysis established a strong negative association among profitability measures and degree of aggressiveness in working capital investment strategies and financing strategies. Raheman A, & Nasir (2007) explicated about many of Pakistan's companies which have invested huge amounts on working capital. Therefore, that can be predicted about the method through which working capital is considered, might have considerable effect on profitability measures.

Agyei & Yeboah (2011) revealed that as cash operating cycle increases the profits of the banks also increases, just like debtors' collection period, whereas creditors' payment period parades a significantly reverse relationship with profitability. Some other factors like, credit risk, exchange risk, capital structure and size also significantly increase bank profitability. Unexpectedly, however listed banks appear to perform poorly as compared to unlisted banks. Joshi (2013) institute a significant relationship between net profit and net working capital, and conclude that net profit increases/decreases with the increase/decrease in net working capital. The management of working capital is more liable to top level management rather than lower level stratum. Moreover the long run sustainability of banks requires risk taking and adoption of aggressive policy for profitability. There is a significant positive relationship between the working capital management, and the profitability of the Deposit Money Banks (DMBs). Thus, for attaining the objective of maximizing the profitability, the banks are to confirm the appropriate management of working capital (Adagye, 2015).

Kimani et al (2014) initiate that debtors' collection period (DCP) and cash conversion cycle (CCC) both have significant inverse relationship with liquidity of quoted commercial banks. It means that more liquid banks collect cash from their customers in the shortest time. The positive sign of creditors' payment period implies that the longer the bank takes to pay its creditors, the more liquid it is. They recommend that commercial banks should maintain their current assets for meeting their short term obligation so increase their liquidity by shortening their debtors' collection period and cash conversion cycle whereas increasing their creditors' payment period for better liquidity position. Gamlath, G R M & Rathirane, Y (2014) inspect the relationship between working capital management and profitability of Sri Lankan listed commercial banks. The working capital management has been presented by current ratio (CR), loans to deposit ratio (LDR) and cash ratio (CSR) and the profitability including the net profit margin (NPM), return on equity (ROA) and return on capital employed (ROCE). The results showed that the cash ratio has great impact on net profit margin and return on equity than other factors such as savings, interest rates. Working capital management has a great impact on the profitability the managers will have to increase value of the banks to control the optimal level of working capital position.

Yahaya, A, & Bala, H. (2015) stated a direct association for current ratio and quick ratio and return on assets of Money Banks in Nigeria, whereas cash ratio is inversely but significantly related to return on assets there.

The study recommends that higher liquidity indicates more profitability, hence the management should enhance their liquidity and quick ratios. In order to maintain an adequate liquidity as the study has empirically proved that higher liquidity signifies more profitability, the listed Deposit Money Banks in Nigeria should try and maintain a higher quick ratio as it will have a positive impact on their profitability. Similarly management should reduce the current asset because by investing the current assets, the banks can yield higher return.

### 2.1. Literature Gap

A lot of literature clearly exhibits that working capital management is related to the manufacturing concern but some of the studies employed this concept in banking sector (Yeboah & Agyei ,2012; Adagye, 2015; Kimani et al, 2014). The present study might be worth considering as it concentrates on the scheduled commercial banks listed on Pakistan Stock Exchange and provide a base and ground for further researchers who are interested to work in the same field.

We have extended the work of Tallut Afza (2008) & Yeboah & Agyei ( 2012) by increasing the time period, adding some more independent variables in the investigation and targeting specific area that is scheduled commercial banks, for the generation of some meaningful and authentic results.

## 3. DATA DESCRIPTION AND ECONOMETRIC METHODOLOGY

Dr. Tallut Afza has explored some hidden findings regarding aggressive and conservativeness of Working Capital Management policies. Whereas, Yeboah & Agyei attempted to explore the working capital management in the context of banking sector. Both of the studies help to achieve the objectives of this study. The impact of working capital investment and financing policies will be identified and its effects on the profitability and liquidity of Pakistani banking sector with controlled variables in investigation. Profitability of manufacturing concerns can be identified by return on asset (ROA) and return on equity (ROE) and liquidity with cash to cash equivalent (CCE).

### 3.1 Data Description

The study employed secondary data with annual reports of commercial banks listed in KSE. Financial data has been gathered from State bank of Pakistan, KSE and websites of commercial banks. With that, the statistical reports generated by SBP were also used to collect data. The selected sample will be comprised of annual audited financial reports of 30 commercial banks that are duly scheduled on KSE for the time period of 2009 to 2013.

#### 3.1.1. Dependent Variables

##### Return on Assets (ROA)

$$\frac{\text{Net profit after tax}}{\text{Total assets}} * 100$$

It is defined as “the ratio of net income to total assets”. This ratio expresses the capacity of earning profit by a bank on its total assets employed in the business. It is calculated as percentage of net profit after tax to total assets. It is useful for whole financial sector (Ehrhardt, 2011)

##### Return on Equity (ROE)

$$\frac{\text{Net profit after tax}}{\text{Total shareholder's equity}} * 100$$

Total Shareholder’s Equity (Pakistani Banks) = Share Capital + Reserves + Un-appropriated Profit (Loss). Total Shareholder’s Equity (Foreign Banks) = H.O Capital Account+ Reserves+ Unremitted Profit. This ratio represents the return on shareholder’s equity. ROE is a direct measure of returns to the shareholders. It is calculated as a percentage of net profit after tax to net shareholder’s equity. It’s useful to measure the profitability of the banks (Ehrhardt, 2011).

##### Cash and Balances with Banks to Total Assets

$$\frac{\text{Cash balance with banks}}{\text{Total assets}} * 100$$

This ratio expresses the percentage of total assets available in the form of highly liquid assets (Yeboah & Agyei, 2012). It shows the relationship between Investment and total assets which reflect investment activity with reference to its total assets or we can say that how much of total assets have been used for investment in various venues. This ratio is useful for banks, DFIs and insurance companies (SBP Publications).

#### 3.1.2. Independent Variables

##### Aggressive Investment Policy (AIP)

The company’s aggressive technique is defined as when firm engaged its maximum proportion of investment in long term or permanent assets and on the other hand using this long term financing for current assets or working capital deficit financing. The second acute technique for working capital financing is when a company’s decision to utilize mostly long term sources of financing and extremely modest short term sources of financing in order to funding working capital. In contrast, conservativeness of investment Policy, companies put greater quantity of invested capital in highly liquid or Current Assets with lesser opportunity of earning high profitability.

$$AIP = \frac{TotalcurrentAsset(TCA)}{TotalAsset}$$

If the result of this ratio obtained is low then that means a relatively aggressive policy. There is a negative relation between aggressive investment policies with firm's profitability (Afza & Nazir, 2008). Some of the findings declared that investment policy has positive significant relation with return on equity whereas negative significant with return on asset (Y, O, & O, 2014).

### Aggressive Financing Policy (AFP)

In Aggressiveness of Financing Policy (AFP) companies engaged elevated levels of short term assets and liabilities or current natured liabilities and puts low level of investment in long term liabilities in contrast, conservative financing policy consider more long-term debt. The level of aggressiveness in financing policy is adopted by a company and is measured by following formula.

$$AFP = \frac{TotalcurrentLiabilities(TCL)}{total Assets}$$

If the results of ratio is high then this means a relatively aggressive policy. Aggressive financing policy negatively related with firm's profitability (Afza & Nazir, 2008; Y, O, & O, 2014).

### Cash Conversion Cycle (CCC)

Working capital cycles in which firms can buy or produce inventory, then hold it as inventory for a time, then after selling they receive cash. This process is known as the cash conversion cycle (CCC). Cash conversion cycle is net out of debtor collection period, inventory turnover period and creditor payment period. Here for the banks inventory turnover period is not calculated (Brigham & Ehrhardt, 2011).

$$CCC = Debtor Collection Period - Creditor Payment Period$$

It is negatively related to cash to cash equivalent (Yeboah & Agyei, 2012) and to return on asset (Mansoori & Muhammad, 2012; Iqbal & Zhuquan, 2015) but it is positively related to return on equity (Wesley, Musiega, & Douglas, 2013).

### 3.1.3. Control Variables

We have used certain controlled variables so that their effects would be neutralized like other researchers did, such as (Lamberson, 1995; Smith & Begemann, 1997; Deelof, 2003; Eljelly, 2004; Teruel & Solano, 2005; Lazaridis & Tryfonidis, 2006). Following are the few variables that have been identified in order to make them neutral so that working capital policy's impact can be gauged, here are the variables which include, financial leverage and bank size used as controlled variables in this study.

Bank size = Total assets of the bank

Leverage Ratio = Total Liabilities / Total assets

### 3.1.4. Model specification

$$ROA_{it} = \alpha + \beta_1(AIP_{it}) + \beta_2(AFP) + \beta_3(CCC) + \beta_4(LVRG_{it}) + \beta_5(SIZE_{it}) + \varepsilon_{it} \dots (1)$$

$$ROE_{it} = \alpha + \beta_1(AIP_{it}) + \beta_2(AFP) + \beta_3(CCC) + \beta_4(LVRG_{it}) + \beta_5(SIZE_{it}) + \varepsilon_{it} \dots (2)$$

$$CCE_{it} = \alpha + \beta_1(AIP_{it}) + \beta_2(AFP) + \beta_3(CCC) + \beta_4(LVRG_{it}) + \beta_5(SIZE_{it}) + \varepsilon_{it} \dots (3)$$

Where,  $i = 1 \dots 30$   $t = 2009 \dots 2013$

ROE = Return on Equity.

ROA = Return on Assets.

CCE = Cash and Balances of Bank

CCC = Cash Conversion Cycle.

SIZE = Natural log of Bank's Size.

LVRG = company's Financial leverage.

AIP (TCA/TA) = Aggressive Investment Policy captured by dividing total current assets to total assets.

AFP (TCL/TA) = Aggressive Financing Policy captured by dividing company's Current Liabilities to total assets.

$\alpha$  = Intercept.

$\varepsilon$  = Error term of the model.

### 3.1.5. Hypotheses of the Study

**H<sub>01</sub>**: There are no significant effects of working capital management on banks' performance.

**H<sub>11</sub>**: There is a significant effect of working capital management on banks' performance.

**H<sub>02</sub>**: There are no significant of effects working capitals financing policies on banks' performance.

**H<sub>12</sub>**: There is a significant effect of working capital financing policies on banks' performance.

**H<sub>0</sub>**: There are no significant effects of working capital investment policies on bank' performance.

**H<sub>13</sub>**: There is a significant effect of working capital investment policies on banks' performance.

**H<sub>04</sub>**: There are no significant effects of size on banks' performance.

**H<sub>14</sub>**: There are significant effects of size on banks' performance.

**H<sub>05</sub>**: There are no significant of leverage on banks' performance.

**H<sub>15</sub>**: There are significant effects of leverage on banks' performance.

### 3.1.6. Econometric Methodology

Panel data has been gathered in order to evaluate and demonstrate the effects of bank's aggressive and conservative working capital policies on profitability and liquidity measures. This impact will be gauged by applying the panel data regression analysis for thirty scheduled commercial banks over the time period of five years.

## 4.RESULTS AND DISCUSSION

This study tests the hypothesis by using the panel data techniques, fixed effect vs random effect. The Hausman test was employed to select between fixed and random effect model. Hausman test preferred in most of the hypotheses testing the fixed effect model but in some of the hypotheses it also chose random effect model. Hence, the results were reported in both fixed effect and random effect models. There were three equations which were employed for testing the hypothesis.

**Table 1 Regression Analysis of Working Capital Policy & its Management with the Profitability and Liquidity measures**

Variables	Model 1			Model 2			Model 3		
	Return on Asset (ROA)			Return On Equity (ROE)			Cash to Cash Equivalent (CCE)		
	Coeff.	t-Stat	Prob.	Coeff.	t-Stat	Prob.	Coeff.	t-Stat	Prob.
<b>C</b>	-0.417	-3.376	0.00	-11.04	-1.870	0.06	0.1237	1.060	0.29
<b>AIP</b>	0.2320	3.085	0.00	14.18	4.39	0.00	-0.076	-4.878	0.00
<b>AFP</b>	-0.039	-1.72	0.08	-5.064	-2.807	0.00	-0.070	-0.99	0.32
<b>LNCCC</b>	-0.015	-5.37	0.00	-0.956	-2.355	0.02	0.018	1.143	0.25
<b>LNSIZE</b>	0.021	3.71	0.00	0.713	3.180	0.00	-0.006	-3.03	0.00
<b>LVRG</b>	-0.0837	-1.632	0.106	-9.016	-3.365	0.00	0.022	0.624	0.53

Using panel data methodology, within the framework of the fixed effects model, the results show positive coefficient which means there is a negative relationship between aggressive investment policy and profitability (return on asset and return on equity) of the banking sector. The theory postulate if there is a positive coefficient it means there is an inverse relationship between relative degree of aggressiveness of working capital investment policy and profitability, TCA/TA increases, degree of aggressiveness decreases, and return on assets increases (Gitman & Zutter, 2012). This means the banks are not earning profit by investing in current asset as they follow conservative policy, they need to invest more in fixed assets rather than current assets (Mwangi & Kosimbei, 2014; Nazir & Afza, 2009). The reason behind fixed asset being more profitable as compared to current assets is that they add more value to the product which cannot obtain without fixed asset (Gitman & Zutter, 2012). These results vary with the previous findings as with those of Carpenter and Johnson (1983), Gardner, Mills and Pope (1986), and Weinraub and Visscher 1998, because their studies were based on industrial sectors. In model 3, within the framework of the random effects model there is a positive relationship between aggressive investment policy and cash to cash equivalent (CCE) as current assets are liquid in nature so more investment in current asset increases the cash to cash equivalent. With the increase of current assets the net working capital increases, which reduces the risk of insolvency. In banks cash and balances with Treasury banks, provision against advances, lending to financial institutions and Investment etc. are the sources of current assets. Investment in cash and Balances with other banks or institutions are less risky than fixed assets. The nerer the asset to cash, the less risky it is. So more investment in current assets by banks may reduce the risk and increase its liquidity, as the opposite effects on profit and risk result from a decrease in the ratio of current assets to total assets (Gitman & Zutter, 2012).

There is a negative significant relationship of degree of aggressive financing policy with the profitability (return on asset and return on equity) of the banks Weinraub and Visscher (1998). Here the negative coefficient depicts the inverse relationship with the profitability and liquidity (Gitman & Zutter, 2012). This means the bank prefers conservative financing policy by getting finance through long term debt. In other words, the current liabilities (in the form of deposit) of the banks are not properly utilized, which restrict the profitability. The relationship of aggressive financing policy with cash to cash equivalent (CCE) is negative and insignificant. This means more deposit taken by the bank cannot increase its liquidity. Mostly firms use current liabilities to finance its clients as it is less expensive than long-term financing. Hence the ratio of current liabilities to total assets increases, the risk of insolvency also increases because the increase in current liabilities in turn decreases net working capital (Gitman & Zutter, 2012). But in our case results are converse indicating that banks prefer to finance with long term debts.

The relationship of cash conversion cycle (CCC) with the profitability of the bank is negative significant (Yeboah & Agyei, 2012; Hassan, Imran, Amjad, & Hussain, 2014; Vural, Sökmen, & Çetenak, 2012; Kaddumi & Ramadan, 2012). The increase in cash conversion cycle means that more of the payments are still to be collected from debtors (advances loan to the customers), which eventually decreases the profitability of the bank. There is a positive insignificant relationship of cash conversion cycle with the cash to cash equivalent. These findings are of opposite to the Agyei & Yeboah, 2011; Samuel Kwaku Agyei & Benjamin Yeboah, 2011, as they believed that by

prolonging the payment periods, banks hold more cash and may create investment opportunities but it may damage the credibility of the bank.

There is a significant positive relationship between the size of the bank and profitability measures (return on asset and return on equity). The size of the bank reflects the total assets of the bank, and with the increases in size of bank, profitability also increases (Agyei & Yeboah, 2011; Mwangi & Kosimbei, 2014). Whereas, there is a negative significant relationship of size of bank with cash to cash equivalent (Yeboah & Agyei, 2012). We have found that there is a significant negative relationship between the leverage of bank and profitability measures (return on asset and return on equity)(Vural et al., 2012). Whereas, the random effect model showed that there is an insignificant relationship of leverage with cash to cash equivalent. The cash holding of the bank decreases with their large size, it means in Pakistan, banks are more related to high leverage and collateral capacity to keep low level of cash.

## 5.CONCLUSION

The summary of these findings explores that the commercial banks of Pakistan follow conservative investment and financing policy. This means that the banks invest more in fixed asset and get finance through long term debt. It was observed that the banks are investing more in fixed assets rather than current assets, because fixed assets are more profitable as compared to current assets, they add more value to the products which cannot be obtained without fixed asset (Gitman & Zutter, 2012; Mwangi & Kosimbei, 2014). The liquidity of the bank is unaffected by the deposit of its customers because it focuses on investment and cash balances with other institutions. There is a dire need for banks to focus on current assets because it's less expensive and less risky.

The preference of banks to conservative financing policy means that the current liabilities (in the form of deposit) are not being properly employed by the banks which reduces the profitability. Even the deposits of customers taken by the bank cannot enhance its liquidity. Banks need to utilize more of current liabilities for financing because through interest they earn more profit and get more cash at the bank because the risk of insolvency is less in current liabilities as compared to long-term financing(Gitman & Zutter, 2012).

Working capital management measurement for banking sector based on the debtor collection period, creditor payment period and the net of both equal to cash conversion cycle of the banking sector as inventory is not a part of it. A positive cash conversion cycle (CCC) means investing more in current assets by negotiating its current liabilities (such as bank loans) and negative cash conversion cycle that the firm does not pay its suppliers even though it collected from its receivables (Gitman & Zutter, 2012).. The goal is to minimize the length of the cash conversion cycle. The study revealed that the banking sector is not able to reduce its CCC, somehow it may increase its liquidity but on the contrary, it may reduce the profitability. Banks may use their compensating balances, mail, processing and clearing help to minimize the CCC(Brigham & Ehrhardt, 2011). They need to establish a *target* cash conversion cycle and then manage the *actual* cash conversion cycle and monitor if it moves towards the targeted value or not.

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