Working Capital Management (WCM) and its Impact on Profitability of Royal Insurance Corporation of Bhutan Limited (RICBL)

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Abstract

This study wanted to investigate the working capital management and its impact on the profitability of Royal Insurance Corporation of Bhutan Limited. Royal insurance corporation is one of the oldest non-financial institutions incorporated in 1975. Researcher applied nine years' data from 2010 to 2018. Secondary data was collected from the annual reports and official documents of RICBL. The study analysis data by applying financial and accounting tools like current ratio, quick ratio, standard deviation, Karl Pearson's correlation coefficient and t-test etc. The study drew the conclusion that there is positive relationship between quick ratio and working capital turnover. The finding also reveals that the insurance companies can boost their performance in terms of profitability by managing working capital appropriately.

Keywords: WCM, RICBL, BIL, GIC, WCTR

1. Introduction

Insurance can be defined as a simple mechanism of some people who are exposed to the risk of suffering destruction of damages to their properties that are likely to be cause by the accidence, fire, flood, and earthquake coming together.(Research Proposal on insurance, 2015)The people who live in is imperfect with lots of risk developing around us. Generally, Insurance Company provides the services like life insurance, car insurance, land insurance, rural life insurance, and property insurance. Insurance Companies are important because these companies are large investors in financial markets and Insurance companies are also the growing link between the insurer and banks.

The Royal Insurance Corporation (RIC) provides the security against losses to the insured and to share the risk over several persons who are insured against the risk. In Bhutan there are types of Insurance Company. There are:

1. Royal Insurance of Corporation of Bhutan Limited
2. Bhutan Insurance Limited
3. GIC-Bhutan Reinsurance Co. Ltd.

1. Royal Insurance of Corporation of Bhutan Limited

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The Royal Insurance Corporation of Bhutan Limited was incorporated on 7th January 1975 under the Charter of His Majesty the fourth Druk Gyalpo Jigme Singye Wangchuck, primarily to meet the insurance need of its citizen as well as to actively participate in the economic development of the nation.(Royal Insurance Corporation of Bhutan Ltd, n.d.)Later on October 11, 1991, Royal Insurance Corporation of Bhutan (RICBL) was incorporated as a public limited company. Two years later, it was listed on the Royal Securities Exchanged of Bhutan. Today 61 percent of the company is owned by public and private organization, 18 percent by Druk Holding and Investment. And the remaining 21 percent by His Majesty's welfare fund.

2. Bhutan Insurance Limited

Bhutan Insurance Limited was incorporated under the companies Act of the Kingdom of Bhutan 2000 in the year 2009, and it is licensed to engage in the business of general insurance by the Royal Monetary Authority of Bhutan. Bhutan Insurance Limited has a countrywide network connected through the latest technology for quick communication and response in over 13 dzongkhags. Bhutan Insurance Limited is listed with the Royal Securities Exchange of Bhutan Limited (RSEBL) since 2009. Bhutan Insurance Limited was authorized by the RMA (Royal Monetary Authority) to provide the financial and investment services and manages private provident fund and Gratuity Fund. Bhutan Insurance Limited provides various non-life insurance products for individual, corporate bodies, and for small and medium size enterprise throughout Bhutan. BIL also offers reinsurance services and has well established global reinsurance companies. (BIL, 2021)

3. GIC- Bhutan Reinsurance Co. Ltd.

GIC-Bhutan Reinsurance Company Limited was incorporated on 16th may 2013 under the companies Act 2000 of the Kingdom of Bhutan. The company was licensed to carry on General Reinsurance business on 12th August 2013 under financial services Act 2011. The company was formally launched on the 5th of September, 2013, by the Hon'ble Finance Ministry of Bhutan. (GIC, 2021)

Working capital management (WCM) is known as short term financial management and it is mainly concerned with the decision making based on current assets and current Liabilities. Working capital involves managing the relationship between a firm's short-term assets like cash and account receivable (customers' unpaid bills) and its current liabilities such as account payable or short-term debt obligation. Working capital management is essentially an accounting strategy with a focus on maintenance of sufficient balance between company's current assets and liabilities. In a financial affair of the organization, working capital is important factor for the organization because working Capital is like base for the company to maintain smooth and continuous flow of the organization and also helps in covering their financial obligation and helps in boosting their earning. Working capital has direct impact on the organization profitability and liquidity. The type of Working capital are gross working capital, networking capital permanent working capital/fixed working capital and temporary working capital/variable working capital. Where the gross working capital is the total investment in the current assets and net working capital is the excess of current asset over current liabilities and permanent working capital is the minimum level of current assets required by a firm to carry on its business as per the minimum amount of current assets over current liabilities. While temporary working capital is the excess amount a business needs over permanent counterpart. The objective of WCM is to attain the objective of a firm by providing sufficient liquidity and profitability of a firm.

2. Research Objectives

I. To evaluate the effect of working capital on financial performance of RICBL.
II. To assess the challenges faced by RICBL.

Hypothesis testing is applied for analytical purposes.

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t-test to test the significant of coefficient of relation between quick ratio and working capital turnover ratio at 5% significant level.

H_0: Quick ratio has relation with working capital turnover ratio.

H_1 – Quick ratio has no relation with working capital turnover ratio.

H_{0-}Null Hypothesis

H_{1-} Alternative Hypothesis

3. Scope of the study

The scope of this study is (RICBL) which is listed under Royal Securities Exchange of Bhutan Limited (RSEBL). The duration for this study is 9 years from 2010 to 2018. RICBL is used as the sample of the study. It is mainly because of time constraint and also, remaining insurance companies can be taken for future study. Moreover, it is also possible to have comparative study among the three companies of Bhutan.

Significance of the study

The study depicts the effect of working capital management on the financial performance of RICBL. Through this study the company can bring improvement in the daily operations of the business and let the company knows that how the working capital affects the operation of the company. It also helps the company in proper decision making and improving their venue policies through this study. The focus is on RICBL and its ability to operate its business efficiently through continuous monitoring and handling its current assets and current liabilities.

4. Literature Review

The central concern of research was to explore literature related to the theme of the present study. Literature has been pursued under several sections namely studies on impact of working capital on banking sectors, studies on effects of working capital management on liquidity of hotels, role of working capital management based on profitability between finance and accounting and study on impact of working capital management on profitability of small and medium enterprises.

Literature Review on Insurance Company:

According to Jayarathne (2014), it stated that the working capital management is a crucial component of financial management and its crucial effects on profitability and liquidity of insurance firms. Moreover, most of the literature have identified that optimal working capital management positively contributes to the firm value. This study was based on the data from the year 2008- 2012 which was listed insurance companies in the Colombo Stock Exchange investigated the effect of working capital management on profitability. The findings suggest that the profitability is negatively associated with the account receivable period, inventory turnover period, and cash conversion cycle. Further, it was found that the profitability is positively associated with account payable period. Moreover, the evidence suggests that increase in leverage leads to decline in profitability. Therefore, the findings of the paper reveal that insurance companies can boost their performance in terms of profitability by managing working capital appropriately.

The study conducted by Waweru (2011), it sought to assess the relationship between working capital management and profitability of insurance companies in Kenya. The study covered a sample of eighteen (18) insurance companies. The data covered a period of five years starting from 2005 to 2009. The researcher used secondary sources of data obtained from the insurance companies' websites, Association of Kenya Insurers (AKI), Capital Markets Authority (CMA) and Nairobi Securities

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Exchange (NSE). The data collected was analyzed using descriptive and quantitative techniques. The findings of this study show that there is a positive relationship between working capital management and profitability in the insurance industry in Kenya. It also shows that when accounts receivable period increases it will have a positive impact on profitability. It further indicates that if the debt ratio is increased, then profitability would increase.

According to Ahmed *et. al* (2010) it stated the impact of firm level characteristics on capital structure of life insurance companies of Pakistan. For this purpose, leverage is taken as a dependent variable while profitability, size, growth, age, risk, tangibility of assets and liquidity are selected as independent variables. The result of the OLS regression model indicates that size, profitability, risk, liquidity and age are important determinants of capital structure of life insurance companies.

Jagongo & Ochieng (2020) conducted the study to find out the effects of working capital management practices on the financial performance of Insurance companies in Kenya. The reason for conducting this study is to depict the working capital management practices and evaluate the relationship between working capital management practices and the financial performance of insurance companies. The study used the descriptive research design. The finding of the study is that the working capital management of the insurance companies in Kenya had positive effect on financial performance.

The study was conducted by Abbas and Yusan (2016) to find out the relationship between the working capital management and its effect on profitability on insurance companies. This study was based on reports from the year 2006 to 2010. The necessary and required data are taken out from the financial statements of chosen companies which are evaluated using STATA software. The end result was that it depicts the strong negative correlation between WCM and the company's profitability, and the effect of working capital management on the size of the company and its profitability. Thus, working capital should be managed well to increase the profit and should be financially planned.

Abbas *et.al* (2016) stated that it is a descriptive assessment with the aim to evaluate the relationship between working capital practices and its effects on profitability of Insurance Companies for a period of five years from 2006 – 2010. Data are obtained from financial statements of the selected companies, and analyzed by using STATA software. The consequence shows there is strong negative correlation involving components of the working capital management along with profitability of the companies, also constructive correlation involving size of the company and its profitability. The recommendation is to advise active working capital management matters in profit maximization and, thus, should be included in a company's financial planning.

In the light of above reviews, the study found a positive effect of working capital management on profitability of various industries. Based on the different studies done by different researchers, the methods they have used for the study were trade credit policy and inventory policy; the cash conversion cycle, panel data analysis, pooled OLS, Correlation matrix, regression analysis, the ordinary least squares with robust standard errors. So, along with their method, this study will be using Ratio analysis to determine the effect of working capital on financial performance of RICBL.

Research Gap

Literature review helps in identifying certain research gaps. The major research gaps are:

- There is limited research done on insurance companies specially related to working capital management. Research focuses more on the manufacturing companies and need to explore on insurance company, banking sector and IT sectors.
- Moreover, there is less research done on the components of the Working Capital Management related to insurance company.
- There is no research done till date on any Insurance company's working capital in Bhutan.

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5. Methodology

Research methodology is the particular strategies or methods utilized to recognize, select, prepare, and analyzed data based on the topic. In a research paper, the methodology allows the reader too fundamentally or critically analyzed the study's validity and quality.

6.1 Design

This study adopts the descriptive research where it describes a population, situation or phenomena that is being studied. The study answers how, when, where and what questions rather than why.

6.2 Sampling Design

From the population of three insurance companies that are RICBL, BIL (Bhutan Insurance Limited) and GIC-Bhutan Reinsurance Co. Ltd. Among the three, RICBL is used as a sample for this study.

6.3 Data collecting procedures

For this study, the secondary data and information required were collected from annual report of RICBL that a company had maintained for past 9 years dated from 2010-2018. For this different data are acquired to see the working capital management of a company with the help of ratio analysis to access its liquidity, profitability and company's efficiency.

6.4 Data Analysis

To find out the performance of the RICBL for the period 2010-2018, researchers used the Ratio Analysis method that includes the following:

1. Current Ratio
2. Quick Ratio
3. Working Capital Turnover Ratio
4. Standard Deviation
5. Coefficient of Variation
6. Hypothesis testing: t-test.
7. Pearson Coefficient of Correlation
8. Linear Regression

Operation Design

Under Ratio analysis there are five types of ratios, such as liquidity ratio, profitability ratio, solvency ratio, turnover ratio and earnings ratio from which the study used three ratios that are Current Ratio, Quick Ratio and Working Capital Turnover Ratio.

Concept of Ratio Analysis: Ratio Analysis is a quantitative method of gaining insight into a company's liquidity, operational efficiency, and profitability by studying its financial statements such as the balance sheet and income statement,(Bloomenthal, 2020)

- **Current Ratio:**

Current Ratio lies under the types of Liquidity Ratio which measures the firm's ability to care the short- term debt obligation. Moreover, liquidity Ratio greater than one indicates that the company is in good financial health and is less likely fall into financial difficulties.

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However, current ratio is the ratio between current assets and current liabilities of the firm. If the organization has high current ratio, it indicates that the firm is capable to pay its short-term debt obligation.

$$CurrentRatio = \frac{CurrentAssets}{CurrentLiabilities}$$

- **Quick Ratio**: it measures current liquidity and position of the firm based on paying off its current liabilities immediately.

$$QuickRatio = \frac{QuickAssets}{QuickLiabilities}$$

$$QuickAssets = CurrentAssets - Inventories - PrepaidExpenses$$

$$QuickLiabilities = CurrentLiabilities - Bankoverdrafts$$

- **Working Capital Turnover Ratio**: it measures the firm's ability to produce sales through efficient use of working capital where, higher ratio indicates more efficiency of the firm.

$$WorkingCapital\ TurnoverRatio = \frac{Netsales}{Workingcapital}$$

$$WorkingCapital = CurrentAssets - CurrentLiabilities$$

$$Netsales = Grosssales - Returns - Allowances\text{–} Discounts$$

- **Standard Deviation**

  The standard deviation is a measure of dispersion of a set of data from its means.
- **Coefficient of Variation**

  The coefficient of variation is a statistical measure of the relative dispersion of data points in a data series around the mean.
- **Hypothesis Testing: t-test**

  The t-test is a statistical test that is used to compare the means of two groups. (Bevans, 2020)

  It is used to determine the significant differences the means of two variables / groups.

  Formula to calculate t-test (Vohra, 2016)

$$\frac{r\sqrt{n} - 2}{\sqrt{1} - r^2}$$

- **Pearsonian Coefficient of Correlation**

  The Pearson correlation coefficient is also known as Pearson's r. It measures the linear correlation between two sets of data. It helps to know how strong a relationship is between two variables. (Glen, 2021)

Data Analysis

Data analysis is the process of systematically applying statistical or logical technique to describe and illustrates or evaluate the data in order to make a smoother and more effective business decisions.

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Table 1:

Current Ratio

Years	Current Asset (Nu in Million)	Current Liabilities (Nu in Million)	Current Ratio
2010	1,999.32	1,601.75	**1.25**
2011	1,305.28	1,802.89	**0.72**
2012	2,004.29	2,758.48	**0.73**
2013	1,679.59	1,955.56	**0.85**
2014	12,332.66	9,657.34	**1.28**
2015	15,187.34	12,136.43	**1.25**
2016	19,403.34	16,121.82	**1.20**
2017	21,582.83	18,294.35	**1.18**
2018	21,036.20	18,796.46	**1.12**

Source: Researcher's compilation

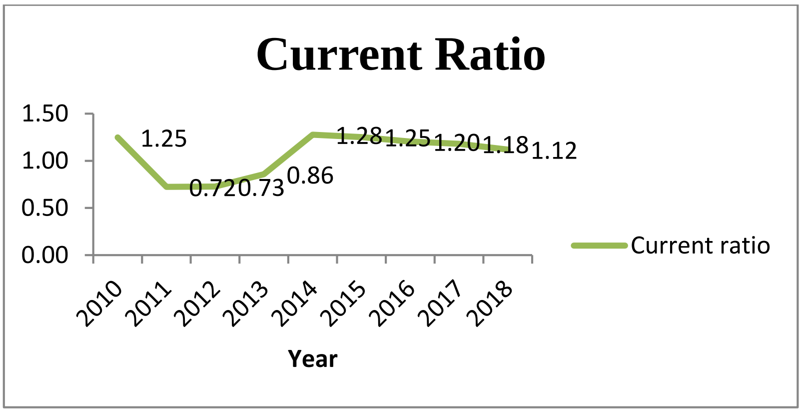

Figure 1: Current Ratio

Current ratio should be 2:1 which indicates that the organization has 2 times more current asset than current liabilities to cover its debts. However, the ratio that is less than 1 indicates that the company does not have enough liquid assets to cover its short-term obligation. As for RICBL, the year 2011 to 2013, RICBL have been suffering to pay its short-term obligation as the ratios were below one (0.72, 0.73, 0.85) which indicates that they are not in a stable position to meet its short-term obligation of the firm. Moreover, they have been improving starting from the year 2014 to 2018 even though, during 2010, they were in stable position but later on they started declining for 3 years. After that they again gained their stability back on covering their debt starting from the year 2014 to 2018 (1.277, 1.251.1.203, 1.179, 1.119) which shows that RICBL has enough assets to pay its debt.

Table 2:

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Quick Ratio

Years	Quick Asset (Nu. In Million)	Quick Liabilities (Nu.in Million)	Quick Ratio
2010	931.98	974.42	0.96
2011	1217.23	1802.9	0.68
2012	1937	2758.48	0.70
2013	1676.42	1955.56	0.86
2014	11915.18	9657.34	1.23
2015	14728.34	12136.43	1.21
2016	18653.78	16121.82	1.16
2017	20703.34	18294.34	1.13
2018	20190.4	18796.46	1.07

Source: Researcher's Compilation

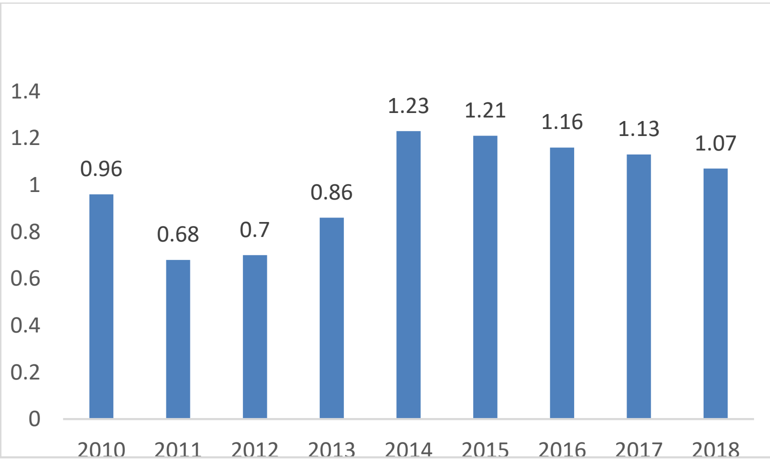

Figure 2: Quick Ratio

Quick ratio indicates company's ability to meet its short-term obligation with its liquid assets and it indicates firm's liquidity position where the ideal ratio is 1:1 which shows that firm has enough assets that can be easily liquidated to pay off the current liability. For RICBL, starting from the year 2010 to 2014, (0.95, 0.675, 0.70, 0.86) the firm was not able to meet its short-term debt obligation with its liquid assets as the ratio was less than one. Moreover, we can say that RICBL is not in the liquid position and starting from 2015 to 2018, (1.234, 1.21, 1.157, 1.131, and 1.074). RICBL has enough assets to meet its short-term obligation and this indicates that the company is using assets and liabilities effectively, they are able to pay their debt on time and the company is in good position.

Table 3:

Working Capital Turnover Ratio

Years	Net Sale (Nu. In Million)	Working Capital	WCTR
2010	311.64	397.57	0.78times
2011	261.44	-57.69	-4.5times
2012	1983.73	-754.19	-2.6times
2013	2537.93	-275.97	-9.2times
2014	3401.29	675.32	5.04times

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2015	503.50	50.87	9.9times
2016	1474.28	319.62	4.6times
2017	1266.98	701.62	2times
2018	1236.38	239.74	5.16times

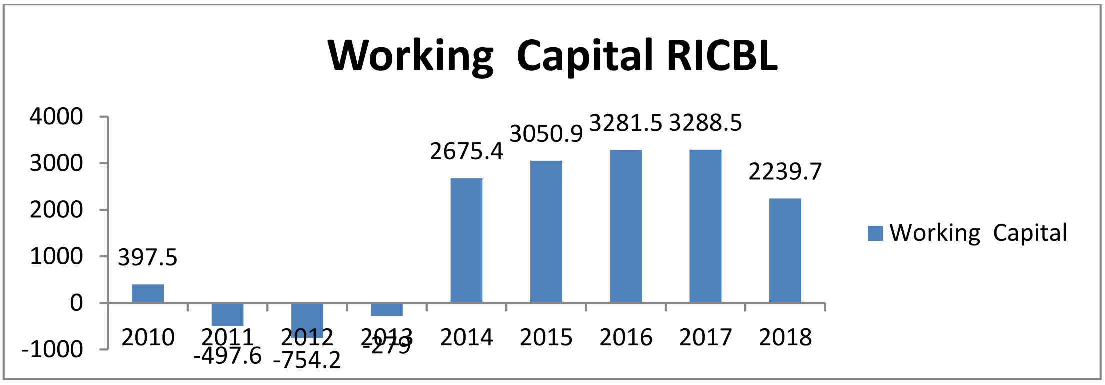

Figure 3: Working Capital Turnover Ratio

Table 3 represents the working capital turnover ratio for the year 2010-2020. Royal Insurance of Corporation of Bhutan (RICBL) performed extremely well in 2010 in terms of working capital turnover ratio. They have been utilizing its working capital effectively to support the given level of sales and they have used the current assets and liabilities efficiently. The lowest ratio was during the year 2011, 2012, and 2013, where it had negative working capital turnover ratio. This is due to having more current liabilities than current assets in these particulars years which resulted in negative working capital. And also, the company had shortage of cash inflows and they couldn't operate properly.

Table 4:

Descriptive statistics

	Current Ratio	Quick Ratio
Mean	1.07	1
Standard Deviation	0.23	0.21
Coefficient of Variation	21.55	21.34

Source: Researcher's compilation

Table 4 represents the mean, standard deviation and coefficient of variation of each ratio that is current ratio and quick ratio. The lowest standard deviation is in the quick ratio (0.21) which shows that the value of quick ratio is close to the value of mean. Since the coefficient of variation of each ratio analysis is greater than 1, it is considered high variance and thus, there is greater level of dispersion around the mean.

For RICBL the coefficient of variation of current ratio (21.55) is greater than quick ratio (21.34) which indicates that the data points are spread out of the mean and shows the volatility or risk associated with RICBL. Moreover, higher level of coefficient of variation indicates greater level of dispersion around the mean and lower the value of coefficient of variation indicates more précised the estimated value which gives better risk return trade off.

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Table 5:

Pearson Coefficient of Correlation

Quick Ratio	WCTR
0.96	0.78
0.68	-4.5
0.70	-2.6
0.86	-9.2
1.23	5.04
1.21	9.9
1.16	4.6
1.13	2
1.07	5.16
Correlation	0.82
R Square	0.67

t-test Hypothesis:

$$= \frac{r\sqrt{n}-2}{\sqrt{1}-r^2}$$

Where n is sample size

n-2 is level of significance

r is Coefficient of correlation

r^2 is coefficient of variation

$$= 0.82\,\frac{\sqrt{9.2}}{\sqrt{1}-0.67}$$

$$= 0.82\,\frac{\sqrt{7}}{\sqrt{0.33}}$$

$$= \frac{0.82\times 2.64}{0.57}$$

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$= \frac{2.16}{0.57}$

= 3.79

There is significant correlation between quick ratio and working capital turnover ratio. It is 0.82 while coefficient of determination is 0.67 on t-test testing. The computed value is 3.79 while the table value for degree of freedom is 7 at 5% level of significance is 2.31. It means null hypothesis is rejected and alternative hypothesis is accepted. The non-explanatory factors have the value of 33%.

The calculated value is 3.79 and tabulated is 2.305. From the above observation, it is clear that calculated value is more than the table value. It means that null hypothesis failed to reject and thus it can be stated that there is significant relationship between quick ratio and working capital turnover ratio.

Level of significance: - 5%

Tabulated value: 2.305

Gross Working Capital and Profitability of RICBL

r	Coefficient of Correlation	0.25
r^2	Coefficient of determination	0.06
$1-r^2$	Coefficient of non-determination	0.94

n=7

Degree of Freedom= 2-7

= 5

H_0= No relationship between gross working capital (Null Hypothesis)

H_1= Relationship between gross working capital (Alternative Hypothesis)

Computed Value = 1.45

Table Value = 2.571

Critical Value = Computed Value > table value

H_0 – Accepted

H_1- Rejected

The relationship between gross working capital and profitability of Royal Insurance Corporation of Bhutan Limited (RICBL) is positive and just 0.25. It is insignificants at 5% level of significance.

On hypothesis testing using t-test techniques at 5% level of significance the computed value is only 1.45 for 5 degree of freedom (d.f) which is less than the table value. In this manner null hypothesis stands accepted consequently alternative hypothesis is rejected.

The coefficient of non-determination is 94%. It means there are other explanatory factors affecting profitability in RICBL.

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Findings

The findings of this study indicate that RICBL

- Has been performing well in the previous years. However, the findings reveal that during the year 2011-2013, the profitability of RICBL is associated negatively with poor management of debts and expenses. Due to bankruptcy or other financial problems, most of the customer of RICBL is unable to pay their debt obligations.
- Since RICBL has extended its credit to their customer, it has led to increase bad debts. In the year 2011, 2012 and 2013, there was less profit for RICBL because of increase in operating expenses. This was due to having more of current liabilities than current assets.
- There is a significant relationship between quick ratio and working capital turnover ratio of RICBL as the calculated value is more than table value.
- The study also shows the volatility or risk where higher level of coefficient of variation results in higher level of dispersion which is not precise in the estimated value that doesn't give better risk return trade off.
- RICBL is not able to meet its debt obligations with its liquid assets as the ratio is less than one which indicates that RICBL is not in liquid position.
- The working capital turnover ratio for the year 2010-2018 is performing well as they have been utilising its working capital effectively to support the given level of sales and they have used the current asset and liability efficiently.
- The finding also reveals that profitability is negatively associated with the account receivable period, inventory turnover period and cash conversion cycle however the profitability is positively associated with account payable period.
- The finding also reveals that the insurance companies can boost their performance in terms of profitability by managing working capital appropriately.
- Therefore, the findings of the study show that RICBL can boost their performance in terms of profitability by managing working capital appropriately.

Conclusion and Recommendation

From the viewpoints of the study, the key recommendation would be:

If RICBL could sell its assets that are not generating return to the business or unproductive assets as they can use cash to reduce current liabilities or debts.

RICBL should set a strict payment policy and keep an up-to- date systems and process of payments to avoid main point here is that RICBL should have a proper working capital management as it helps the company to effectively make a use of current assets and also, maintain sufficient flow to meet short term goals and obligations.

The recommendation is to advice active working capital management matters in profit maximization and thus, should be included in companies financial planning.

To conclude, as intended, the study focuses mainly on the working capital management and the profitability of RICBL that shows major challenges such as increasing bad debts and increasing expenses. Moreover, the study mainly focuses on relationship between working capital management and financial performance of RICBL to evaluate the effect of working capital on profitability, liquidity and efficiency in operation. Therefore, we can conclude that the relationship between gross working capital and profitability of Royal Insurance of Corporation of Bhutan Limited is positively significant.

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