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The Effects of Working Capital Management on Profitability of Microfinance Institutions in Zambia: A Case Study of Bayport Zambia Limited

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ABSTRACT

This study investigated the effects of working capital management on the profitability of Bayport Zambia Limited, a microfinance institution in Zambia. The specific objectives were to find out the effect of cash management profitability of Bayport, to assess the effect of non-performing loans (debtors) on Bayport Profitability, to examine the effect of operational expenses on the Profitability of Bayport and to determine the effect of debt recovery effort on the profitability of Bayport. Data were collected through questionnaires and face-to-face interviews with employees and senior management of Bayport Zambia Limited. Descriptive statistics were used to analyse the data, including frequency distribution and percentages. The study found that effective management of liquid cash is crucial for sustaining and maximizing profits. Weak cash management negatively impacts profitability. Managing and mitigating non-performing loans significantly affects financial performance. Weak management of operational expenses can impact profitability. Timely and efficient debt recovery efforts positively influence profitability. Based on these findings, the study makes several recommendations. Bayport should reassess and strengthen debt recovery strategies, reduce high operational expenses, and utilize technology solutions to effectively monitor customer status. Collaboration with regulatory authorities is necessary to develop and enforce a regulatory framework for responsible lending and efficient working capital management. Financial literacy and education programs should be implemented to promote awareness and responsible borrowing. These recommendations aim to improve working capital management and overall profitability in Bayport Zambia Limited and the microfinance sector in Zambia.

Keywords-- Profitability, Working Capital Management, Loan, Debt

I. INTRODUCTION

Khrawish (2011) defines working capital management as the process of managing a company's short-term assets and liabilities to ensure it has enough liquidity to meet its short-term obligations and operating expenses. It involves managing inventory, accounts receivable, accounts payable, and cash to optimize the company's working capital position. For MFIs, working capital management (WCM) is one of the most crucial financial choices. The most advantageous and efficient WCM strategy influences performance and liquidity while increasing corporate value. The primary objective of WCM is to achieve optimal balance among its components as part of the overall corporate strategy to increase value for shareholders. WCM, or working capital management, is a crucial component of financial management and comprises choices about the quantity, composition, and financing of current assets. WCM involves making judgments regarding various aspects of cash investment, maintaining a specific amount of inventory, and managing receivables and payables accounts (Falope and Ajilore, 2009).

Largest microlender in Zambia and the market leader in payroll-based lending, Bayport Financial Services Ltd., sought to increase lending to low- and middle-income borrowers and small enterprises in order to open up the credit market to common Zambians while also attracting a sizable new clientele (Bayport, 2021). Bayport provides credit which is access to many more low and middle-income workers as well as small businesses, which will lead to investments in new business ventures, small scale agriculture, education and home improvement (Bayport, 2021. Those investments in turn will generate economic growth and new sources of profits for other private enterprises. In addition to expanding Bayport's lending base, raising its profit potential, and encouraging the firm's efforts to strengthen responsible finance practices, the Bayport bond project helped deepen Zambia's domestic capital market, a critical ingredient to financing the country's economy(Bayport,2021) . It also had a positive impact on the private sector by establishing strong financial practices and demonstrating the possibilities for tapping capital markets to fund new business ventures in Africa. Bayport's example is expected to spur other enterprises in the region to issue bonds to broaden their investor base and lower their (KPMG, 2018).

Zambia is one of the many countries that benefit from microfinance institutions. This can be attributed to the fact that these institutions provide financial assistance to small business owners in their core business. This therefore means that small business owners gain access to credit to enhance their business, subsequently leading to economic growth. The provision of financial services to the poor is widely believed to increase incomes and productivity of the poor (Ledgerwood, 1999). Not only do MFI's offer micro-credit but also deposits, loans, payment services, money transfer and insurance to low income households and microenterprises (Asian Development Bank, 2007) However, of recent some microfinance institutions have been closed due to various reasons. According to ZBT (2016), the institutions that have been closed down include, CETZAM, Genesis Finance Limited and Commercial Leasing Zambia limited.

2. LITERATURE REVIEW

2.1 Working Capital Management

Working capital management encompasses all aspects of current assets and liabilities, including cash, inventories, marketable securities, and debtors. Working capital management is a simple and easy notion that refers to a company's ability to fund the difference between its short-term assets and short-term liabilities (Harris, 2005). Working capital management (WCM) techniques can be strategically managed to boost competitive position and profitability, which is the focus of this study, in addition to protecting Bayport microfinance institution from financial instability (Khrawish, 2011). The retail companies are anticipated to gain from working capital management methods at the conclusion of this research, according to Narender et al. (2009). First, working capital management procedures are crucial since they have a direct impact on a company's liquidity (Chiou and Cheng 2006)

Working capital may also offer investors an intriguing indicator. It is crucial as a gauge of the liquid assets that give creditors a safety net. It is crucial for calculating the liquid reserve that can be used to deal with emergencies and the uncertainties surrounding a company's cash flow balance. (Subramanyam and Wild, 2009). In order to further highlight the significance of working capital, it can be put it this way: "managing the firm's working capital is a day-to-day job that guarantees the firm has the resources to continue its operations and prevent expensive interruptions. This covers a variety of tasks connected to the cash receipt and distribution processes within the company (Ross, Westerfield and Jordan, 2008).

2.2 Working Capital Management Policies

A WCM policy is an approach or strategy that stipulates the attitude of a firm towards its working capital needs (Handema, et al, 2020). A firm has to assess what the most important risks are relating to working capital and how they can affect its normal operations and thereafter adopt any of the three approaches, namely; Aggressive, Conservative or Moderate.

2.3 Empirical Review of Working Capital Management and Profitability

Working capital has been utilized by various persons in a variety of ways, as with many other financial and accounting words. There are various ways of thinking about working capital. According to some academics, all capital resources provided by bondholders, shareholders, and creditors are used by a company's operations to produce revenue and support future expansion and growth, hence they should all be regarded as working capital. A different school of thought, however, connects working capital to current assets and current liabilities. These academics contend that the working capital of the company should properly be defined as the difference between current assets and current liabilities. Therefore, working capital refers to the portion of a company's assets that are used for current (day-to-day) activities)

A study by Uddin and Hossain (2020) sought to examine impact of operating expenditures on firms' profitability. Specifically the study examined the impact of operating expense such as salaries and wages, rent and repairs and maintenance, advertising and depreciation, etc. on the profitability of business. The study revealed that operating expenses have a significant impact on profitability and are a key factor in maintaining the company's long-term value. The study revealed that when salaries& wages increases by 10 % operating margin decreases by 8%.

The result also showed that there exist both positive and negative relationships between firms' profitability and operating expenditures. The study found that operating expenses have an inverse effect on a firm's profitability. The study advised that firms that need high levels of cash such as financial institutions need to closely control their operating expenses so as not be starved of cash.

Working capital is a term used to describe the resources (capital) used in a company's daily operations. To maintain a healthy cash flow and be able to pay its short-term commitments as they become due, every business needs sufficient liquid resources. WCM is essential to the organization's long-term success; as a result, a company must establish specific WCM rules for each working capital component (ZiCA 2011).

Olagunju et al., (2011) concluded that for the success of operations and survival, commercial banks should not compromise efficient and effective liquidity management and that both illiquidity and excess liquidity are "financial diseases" that can easily erode the profit base of a bank as they affect bank's attempt to attain high profitability level. Lartey et al (2013) found a weak positive relationship between the liquidity and the profitability of listed banks in Ghana.

According to Ward (2010) working capital is the net investment as a result of a business in commissioning current assets (such as cash and bank, inventories, and trade receivable) and commissioning current liabilities (such as overdraft and trade payables). More over Working capital management is the managing of current resources as well as current liabilities (Creswell, 2003).The management of working capital is very crucial element in firm performance (Paul and Boden, 2008). Traditionally, the study of finance looks at funds management in a direction which will ensure the achievement of a particular objective such as the maximization of returns on capital investment, (Finau, 2011). How such capital will be effectively utilized in financial management is key, in so doing the identifying of the business objective and its financial functions of working capital management is one determinant (Brigham and Ehrhardt, 2010)

Financial needs are mainly classified into two types of needs: working capital needs and fixed capital needs (Khan, 2007). That part of finance which enables an enterprise to perform its day-to-day operations is called working capital. Banks need to analyze short term assets and liabilities carefully in order to manage the firm's liquidity, management of working capital helps managers to manage their operation of the firm through making available cash to pay for short-term debt and the maturity of long term debt as well as expenses resulting for daily operations. So, an optimal level of working capital must be kept to tradeoff between return and risk (Ranjith, 2008).One of the integral components of the overall corporate strategy is to manage working capital efficiency. This needs to control short term obligation as well as decrease investment in liquid assets as much as possible in order to create shareholder value (Eljelly 2004). In practice, Narender, Menon and Shewtha, (2009) show that a firm may lose several profitable investment opportunities or suffer a liquidity problem if the working capital is too low or it is improperly managed

The relationship between working capital management and profitability of listed companies on the Tehran Stock Exchange was examined by Yaghobnezhad et al. in 2010. In the study 86 companies were chosen between the years of 2002 and 2007 for this purpose. The average collection period, inventory turnover, average payment period, and cash conversion cycle were among the working capital management factors whose effects on a company's net operating income were examined in this study. The findings indicate that working capital management and profitability are inversely related.

III. THEORETICAL AND CONCEPTUAL FRAMEWORK

3.1 Theoretical Framework

From among the theories used in this study, the Liquidity theory and Walker's theory were more prominent to this study. These theories provide theoretical evidence on the relationship between liquidity (cash management) and profitability of firm

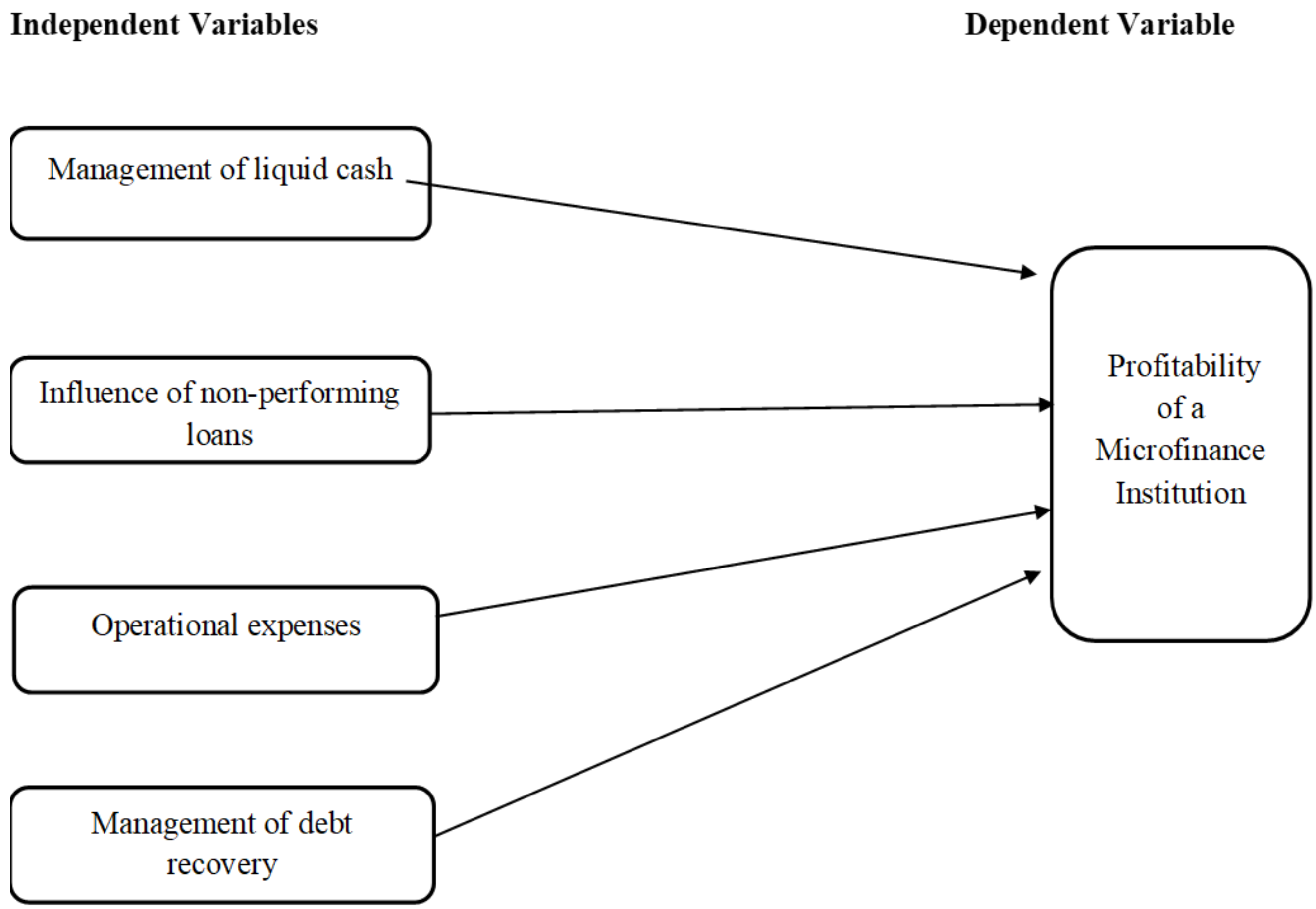
3.1.1 The Liquidity Theory

A bank's ability to meet expected and unforeseen cash and collateral obligations at a fair cost and without suffering intolerable losses is referred to as liquidity. The inability of a bank to fulfil these obligations when they are due without negatively affecting the bank's financial situation is known as liquidity risk. Effective liquidity management can lower the likelihood of major issues. Four theories served as a guide for this study: Working capital management theory according to Walker. Shareholder theory, liquidity preference theory, and cash conversion cycle theory

3.1.2 Walker's Theory

According to this hypothesis, a company's profitability and growth are influenced in part by how its working capital is managed (Asongu, 2013). According to a claim, the turnover of working capital and the rate of return on investment both fall when the flow of cash generated by the movement of working capital is halted for a variety of reasons. According to Walker's thesis, each component of working capital should get capital investment so long as the organization's equity position improves. This is consistent with the idea that every Kwacha invested in working capital or fixed assets should effectively increase the firm's net worth.

3.2 Conceptual Framework



IV. STUDY OBJECTIVES

i. To find out the effect of cash management profitability of Bayport.
ii. To assess the effect of non-performing loans (debtors) on Bayport Profitability.
iii. To examine the effect of operational expenses on the Profitability of Bayport.
iv. To determine the effect of debt recovery effort on the profitability of Bayport.

V. STUDY METHODOLOGY

The study used descriptive survey design which combines quantitative and qualitative approach. Both quantitative and qualitative research approaches were used in this study. This was so because the study sought to measure relationships among variables as well as collect qualitative data from managers at Bayport on how the could improve liquidity management to enhance profitability. Research questionnaire and interview schedule were used in data collection. Descriptive statistics were utilized to analyse the data obtained for this study, mostly using frequency distribution and percentages to ensure that the analysis is simple to grasp (Larina, L.B. et al, 2021) and (Mwanaumo, E.M. et al, 2021). Data interpretations were based on statistical generalization and the analysis will be carried out using statistical tools like Statistical Package for Social Science (SPSS) version 20 and MS Excel.

VI. DATA PRESENTATION AND ANALYSIS

1. Influence of Management of Liquid Cash on Profitability

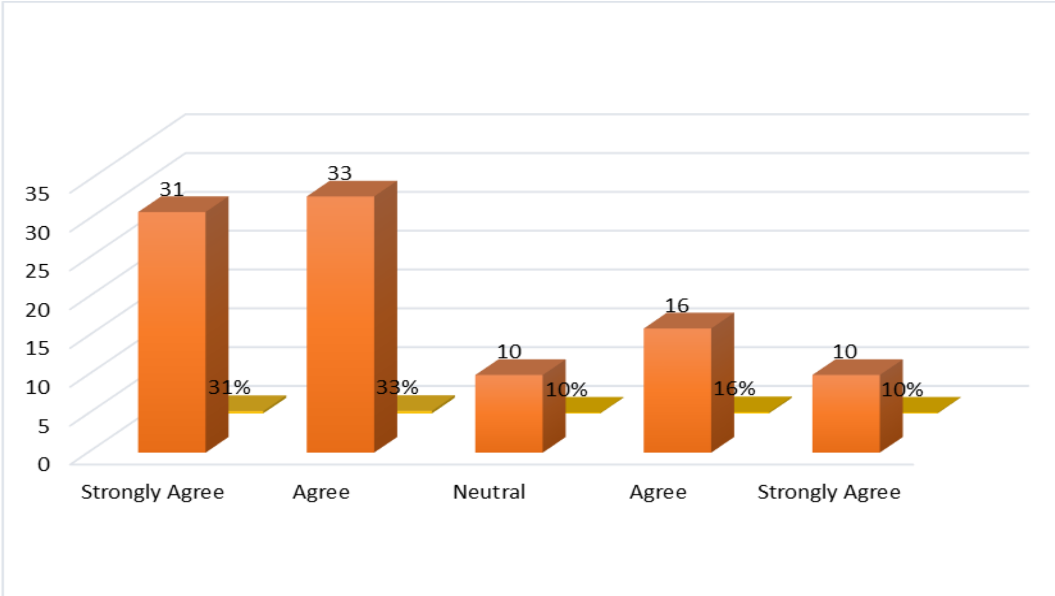


Figure 1: Weak cash management results in reduced profits

The study findings indicated that majority of the respondents agreed that poor management of liquid cash has negative consequences of the operations of the company as it led to reduced profits for the company.

2. Impact of Non-Performing Loans on Profitability

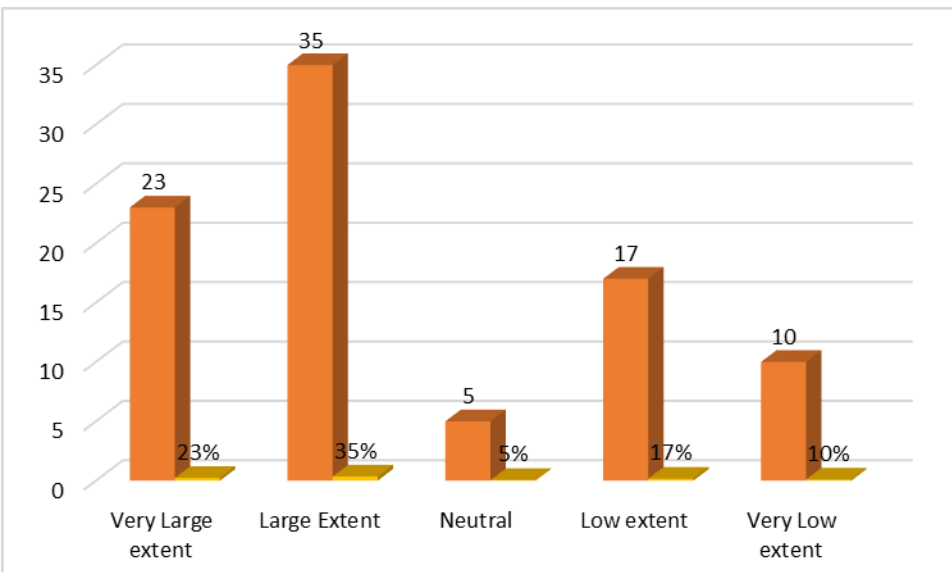


Figure 2: Extent to which NPLs had negatively impacted on Bayport profitability

According to 58% of the responses, non-performing financial loans had negatively impacted Bayport's profitability.

3. Impact of Operational Expenses Bayport Profitability

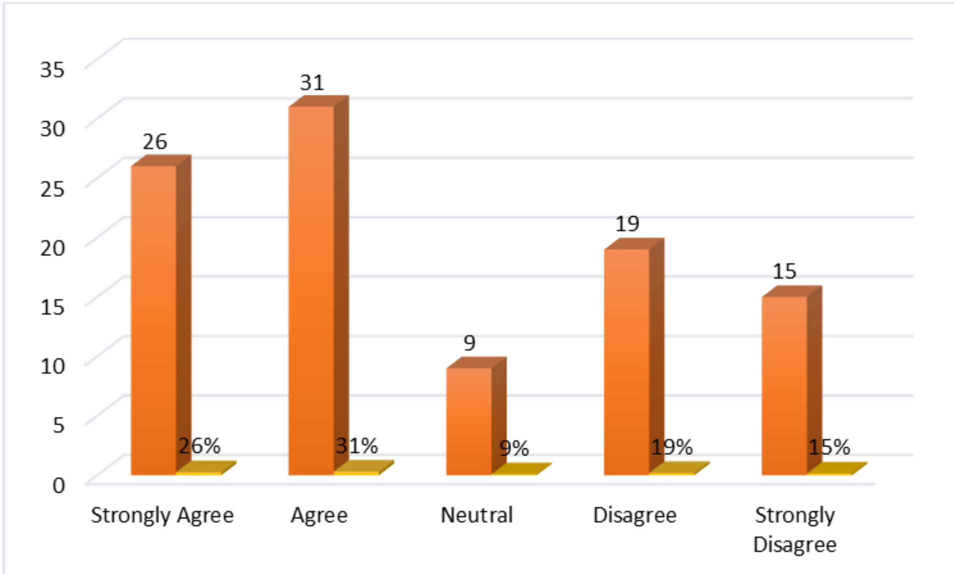


Figure 3: Weak management of Operational results in reduced profits of Bayport

The study findings revealed that majority of the respondents agreed that weak management of operational expenses results in reduced profits. However, it should be noted that a good number of disagreed to the theme. This suggests a widespread acknowledgment among employees that effective operational management is crucial for maintaining or enhancing profitability.

4. Impact of Debt Recovery Effort on Bayport Profitability

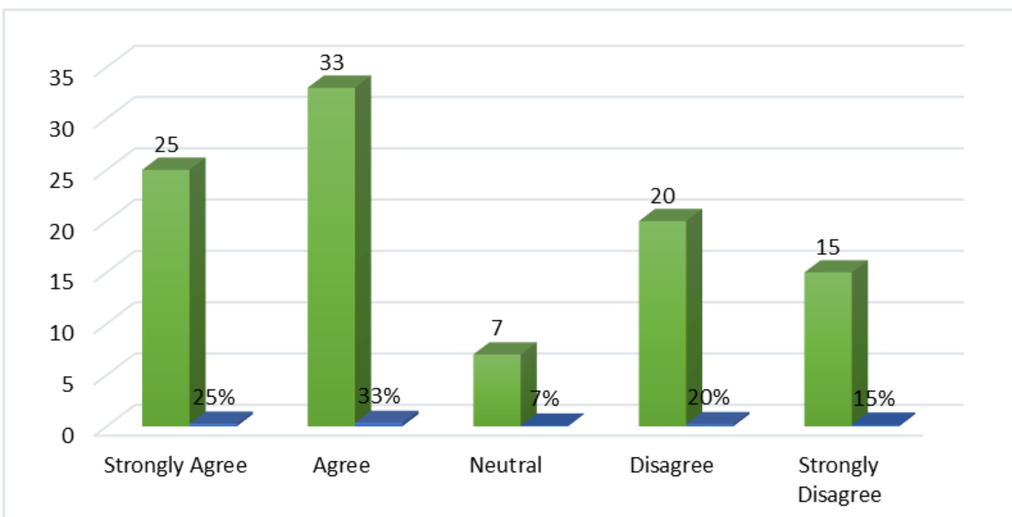


Figure 4: Impact of debt recovery effort on Bayport Profitability

The respondents were requested to indicate their level of agreement with the statement "Debt Recovery Effort's has been weak, thereby negatively impacting Bayport Profitability". Their responses indicate that debt recovery effort greatly have an impact on Bayport profitability. This suggests a widespread acknowledgment among employees that efficient recovery processes are integral to maintaining or enhancing profits.

VII. DISCUSSION OF FINDINGS

7.1 The Effect of Management of Liquid Cash on Profitability of Bayport

The finance manager's perception underscores the pivotal role of efficient cash management in influencing Bayport's profitability. This aligns with Walker's Theory of Liquidity, which posits that a company's growth and profitability are intricately tied to the effective management of working capital (Asongu, 2013). According to this theory, liquidity, defined as a bank's ability to meet financial obligations without incurring significant losses, is crucial for financial stability. The study incorporates various theories as guides, including working capital management theory, shareholder theory, liquidity preference theory, and cash conversion cycle theory. These theories collectively inform the exploration of Bayport's cash management practices and their impact on profitability. Notably, liquidity management is highlighted as a key factor in minimizing liquidity risk and enhancing financial resilience.

The findings resonate with Bordeleau, Crawford, and Graham's (2009) study in the USA, which identified a nonlinear relationship between holding liquid assets and banks' profitability. The study suggested that while holding some liquid assets improves profitability, there's a threshold beyond which further holdings diminish profitability. This aligns with the notion that funding markets reward banks for holding liquid assets up to a certain point. In essence, the study's findings, influenced by the theories cited, affirm the critical importance of prudent cash management for Bayport's financial stability and profitability. The nuanced relationship between liquidity, cash assets, and profitability is well-supported by both empirical findings and established financial theories, contributing valuable insights to the existing literature on financial management in the banking sector.

7.2 The Effect of Non-Performing Loans (Debtors) on Bayport Profitability

The credit manager's observations align with findings in the literature, particularly Buserese's (2016) study on Kenyan microfinance banks, where poor liquidity positions resulting from a high portfolio of bad loans were identified as a factor affecting profitability. This suggests a broader trend within the microfinance sector where the management of non-performing loans (NPLs) significantly impacts financial performance. Microfinance institutions (MFIs), including Bayport, treat loans as assets, and the study by Yeboah and Yeboah (2014) underscores this perspective. However, the credit manager's insights emphasize that these assets can turn into liabilities if not managed effectively. The practice of giving out more loans without rigorous credit analysis, as mentioned in the literature, resonates with Bayport's challenge of delinquent debtors contributing to increase provisioning and potential write-offs.

Moreover, the mention of tripling clients' amounts after a few months of repayment, leading to a sizable portion of the loan portfolio defaulting, reflects the need for Bayport to enhance its credit assessment and monitoring mechanisms. This aligns with the credit manager's recommendation for robust credit management practices to minimize NPLs.

The study findings at Bayport echo broader challenges faced by MFIs, and the literature provides a framework for understanding these challenges and proposing solutions. By addressing the issue of NPLs through effective credit management, Bayport can not only safeguard its financial health but also maintain customer trust and reputation, as emphasized in the credit manager's insights.

7.3 To Examine the Effect of operational expenses on the Profitability of Bayport

The finance personnel's assessment at Bayport aligns with findings from the study by Uddin and Hossain (2020) on the impact of operating expenditures on firms' profitability. The acknowledgment of relatively high operational expenses at Bayport, including costs related to salaries, utilities, and administrative overheads, mirrors the factors examined in the study, such as salaries and wages, rent, repairs, maintenance, and advertising.

The literature indicates that operating expenses, when not carefully managed, can have a significant impact on a company's profitability, supporting the finance manager's observation. The study's finding that an increase in salaries and wages by 10% leads to an 8% decrease in operating margin reflects the sensitivity of operational costs to overall profitability, reinforcing the finance manager's concern about the pressure on profit margins at Bayport.

Furthermore, the literature suggests both positive and negative relationships between firms' profitability and operating expenditures. In Bayport's context, the finance manager's emphasis on evaluating and streamlining operational processes, implementing strategic cost-cutting measures, optimizing resource allocation, and adopting technology-driven solutions resonates with the study's recommendations for closely controlling operating expenses to maintain long-term value. Addressing these concerns at Bayport, as suggested by the finance manager, aligns with the broader understanding in the literature that effective management of operational expenses is crucial for financial sustainability and growth. It emphasizes the importance of Bayport's focus on cost efficiency to positively influence overall profitability, reflecting the study's advice for firms, especially financial institutions, to control operating expenses to avoid cash shortages.

Several studies have shown that operating expenses have an inverse relationship with net profit, meaning that as operating costs increase, net profit decreases. It is important for companies to control and minimize costs in order to enhance profitability and financial health.

7.4 The Effect of Debt Recovery Effort on the Profitability of Bayport

The credit manager's concerns at Bayport regarding the weaknesses in debt recovery efforts align with findings from Padachi's (2006) study on the relationship between liquidity and profitability in a firm's performance. The credit manager's emphasis on timely and efficient debt recovery resonates with Padachi's findings that efficiency in debt collection has a positive impact on a firm's profitability. In the context of Bayport, this implies that addressing weaknesses in the debt recovery process is crucial for maintaining healthy cash flow and minimizing potential losses, thus positively influencing profitability. Padachi's (2006) exploration of the cash conversion cycle (CCC) is particularly relevant to Bayport's situation. The credit manager's observation about the impact of low repayment rates on cash available for new borrowers aligns with CCC's illustration of the gap between expenditure for purchases and the collection of sales. This suggests that the weaknesses in Bayport's debt recovery efforts not only affect profitability directly but also have implications for the availability of cash for new lending, potentially influencing the company's overall financial health.

By reassessing and strengthening debt recovery strategies through enhanced communication channels, proactive follow-ups, and robust collection procedures, as suggested by the credit manager, Bayport aims to strike the right balance between liquidity and profitability. This resonates with Padachi's (2009) broader recommendation that the management of a corporate entity must find the optimal balance between liquidity and profitability for enhanced financial performance.

VIII. CONCLUSION

The study conclusions were as follows:

1. There was a consensus on the negative repercussions of weak management of liquid cash on profitability at Bayport. This aligns with the conventional understanding in business literature that effective cash management is crucial for sustaining and maximizing profits. In essence, the study's findings, influenced by the theories cited, affirm the critical importance of prudent cash management for Bayport's financial stability and profitability
2. There is a negative impact of NPLs on Bayport's profitability. This consensus highlights the perceived importance of managing and mitigating Non-Performing Loans for the financial well-being of the company.
3. This study notes a general consensus among respondents that weak management of operations can impact profitability. The distribution of responses indicates diverse perspectives within the workforce, highlighting the complexity of evaluating the relationship between operational management and financial outcomes at Bayport.
4. There are weaknesses in debt recovery efforts at Bayport Financial services. Management emphasis on timely and efficient debt recovery has a positive impact on a firm's profitability. In the context of Bayport, the company has been addressing weaknesses in the debt recovery process is crucial for maintaining healthy cash flow and minimizing potential losses, thus positively influencing profitability.

RECOMMENDATIONS

Based on the results of the study, the researcher recommends the following:

1. There is need for Bayport to strengthen their Debt Recovery through enhanced communication channels, proactive follow-ups, and robust collection procedures, as suggested by the credit manager, Bayport can strike the right balance between liquidity and profitability.
2. The management at Bayport must address the issue of high operational expenses as this is impacting negatively on profitability
3. Bayport should begin to utilize technology solutions to effectively monitor customer status such as customer relationship management (CRM) systems, to streamline and automate debt recovery processes.
4. Bayport should collaborate with regulatory authorities to develop and enforce a regulatory framework that encourages responsible lending practices and efficient working capital management in MFIs.
5. There is need for Bayport to establish guidelines for debt collection practices to ensure fair and ethical treatment of clients, balancing the interests of both the financial institution and borrowers.
6. Bayport should collaborate with government agencies and non-governmental organizations to implement financial literacy programs targeting clients and the general public. This will help promote awareness about responsible borrowing, financial planning, and debt management to empower clients to make informed financial decisions, reducing the risk of delinquencies.

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