

Cash Flow Ratios for Evaluating Performance in Nepalese Commercial Banks

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ABSTRACT

The purpose of this paper is to examine and analyze the performance of Nepalese commercial banks through cash flow ratios. Descriptive as well as analytical research design has been used. All the government owned commercial banks has been taken as the sample of the study using judgmental technique. Sufficiency and efficiency ratios has been used for evaluating the performance of the concerned commercial banks. Data have been collected through the annual reports of respective banks covering for the financial year 2017/2018 to 2019/2020. All the banks are efficient to generate operating cash flow from sales and continued activities. However the cash generation from continued activities and asset utilization revealed sound in NBL and RBB than ADB in 2019/2020. Cash flow sufficiency revealed similar trends in all banks.

Keywords: Performance evaluation, commercial banks, cash flow ratios.

Introduction

Financial statements is a key tool that provides important information for investors, lenders and assist managers (Nguyen & Nguyen, 2020). Cash flow is the most common financial reports (Helen, 2002), which reflects the profitability and survival of the organization. For analyzing the profitability and risk of the organization, traditional ratios are not always helpful. Traditionally, financial analysis, for a long time, depended on accounting performance via profitability measures such as return on assets and net sales to income, among others are affected by the fundamental drawbacks that are characteristics of accrual based accounting (Albrecht, 2003). Cash flow information assists its financial statement users in obtaining the relevant information concerning the use and source of virtually the entire financial resources over a given time period (Ross et al, 2007). Specifically, the kind of information that the cash flow statement contains include details of operating, investing, and financial activities (Macve, 1997).

Cash flow is an index of the money that is actually received by or paid out by a firm for a certain time period (Albrecht, 2003). Cash flow is viewed in two different ways in construction management literature. The first view defines cash flow as the net receipt or net disbursement resulting from receipts and disbursements occurring in the same interest period (Oxley & Poskitt, 1996; Tarquin & Blank, 1976). Algebraically, this definition is expressed as:

Cash flow = Receipts – Disbursements

Cash flow is regarded as the actual movement or transfer of money into or out of a company (Cooke & Jepson, 1986; Kenley, & Wilson, 1986; Kaka, & Price, (1991; Kenley, 2003). This is represented algebraically as:

Net cash flow = Positive cash flow (Cash in) - Negative cash flow (cash out)

According to Everingham et al., (2003), operating cash flow ratios are indicators of performance to repay loans; maintain operating capabilities; pay dividends; and make new investments without using external financing. It allows to analyst and examine a company's financial health, and how the company is managing operating, investment and financing cash flows (Palepu, et al.,2000). Furthermore operating cash flow may be seen as a more accurate measure of how much a company has generated, in comparison with the conventional profitability measures like net income (Fabozzi & Markowitz, 2006). Cash generated as a result of operating activities is basically a reflection of the transactional effect of cash that helps to determine an entity's net income, or cash received from customers, following a service provision or sale of a product (Berry et al., 2005). Furthermore cash flows from operating activities refer to the principal revenue-producing activities that denote the amounts generated that are available for acquiring assets, paying liabilities and paying cash dividends (Gup et al., 1993).

It is the most scrutinized figure that shows the company's ability to generate consistently positive cash flows from the operations. Cash flows from investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Cash flows from financing activities financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity. However, studies using cash flows to assess the performance of firms like in conventional financial ratio analysis is not common as the other studies.

Ratio analysis is a cornerstone form of financial statement analysis that is used to obtain a quick indication of a company's performance. Yet, ratio analysis of the cash flow statement is not popular as much as the ratio analysis of other primary financial statements, balance sheet, and income statement. Because of the statement of cash flow has been around for a short time, there are limited developed generally accepted analyses and standard or normative values. Farshadfar et al., (2008) examined the relative ability to earn and cash flow data in forecasting future cash flow for Australian companies. They found CFOs powerful in predicting future cash flows than earning and traditional measures. Salehi et al., (2018) studied the effect of cash flow statements on audit fees on the companies listed on the Tehran stock exchange and found that excess cash holdings reduce the audit fees. Atieh (2014) investigated the liquidity position of the pharmaceutical sector of Jordanian companies. The results show a difference between the traditional ratios of balance sheets and cash flow ratios, which derived from the cash flow statement. A response to criticisms of the accrual process used by the accounting profession in assessing firms' financial performance and future cash flows (Neill, et al., 1991). Zordan (1998) provided assumptions on cash flow indicators related to predicting business failures in retail, wholesale and manufacturing businesses. Catanach (2000) showed that all bankrupt firms have problems in the cash flow information, which is reflected in the cash flow indexes calculated through the cash flow statements. Giacomino & Mielke (1993) proposed operating cash flow ratios for relative performance evaluation. Mills and Yamamura (1998) state that cash flow ratios are more liable when evaluating liquidity and analysts have long used these ratios except for auditors. Traditional financial ratio analysis is a way of evaluating the business in terms of accrual basis accounting procedure such as net profit. However, cash flow ratio analysis gives a different perspective to financial statement users about how solvent, liquid, and viable the company is (Hertenstein & McKinnon, 1997). Using cash flow ratio analysis with the conventional balance sheet and income statement ratios should lead to a better understanding of the financial strengths and weaknesses of firms (Carslaw & Mills, 1991). Therefore this study aims:

- (1) To examine the performance of Nepalese commercial banks through cash flow ratios.
- (2) To identify different aspects of cash sufficiency.
- (3) To identify the cash generating efficiency from operation.

Methodology and Results

The government owned commercial banks has been taken as the sample of the study. Judgmental sampling technique has been applied. Different aspects of sufficiency and efficiency ratios has been used for evaluating the performance. This study has followed descriptive as well as analytical research design. This study is based on secondary sources data collected through annual reports of respective banks covering for the financial year 2017/2018 to 2019/2020. Giacomino & Mielke (1993) suggested a set of cash flow ratios for relative performance evaluation using the operating activities that are the primary activities of a company as a component of each ratio. The components and the interpretation of the ratios are summarized as follows;

Table 1 :

Name of ratio	Components of ratio	Interpretation of ratio
	Sufficiency Ratios	
Cash flow sufficiency	CFOA/Long term debt+ purchasing assets+ dividends paid	Evaluates an institutions ability to generate sufficient cash to meet primary obligations
Long term debt repayment	Long term debt repayment/ CFOA	Evaluates the sufficiency of cash flow to settle long term debt
Dividend pay out	Dividend paid/ CFOA	Evaluates the sufficiency of cash to pay dividends

Reinvestment	Purchasing assets/ CFOA	Evaluates the sufficiency of cash flow for reinvestment and maintaining assets structure
Debt cover	Total debt/CFOA	Estimates the number of years to repay debt at the current level of cash flow
Impact of depreciation and write offs	Depreciation + written off/ CFOA	Evaluates the percentages of cash from operating activities due to depreciation and written offs
Efficiency ratios		
Cash flow to sales	CFOA/Sales	Indicates the percentage of sales from operation activities realized as cash flow
Operating index	CFOA/ Income from continued activities	Compares cash flow from operating activities with income from continued activities
Cash flow on assets	CFOA/ Total assets	Evaluates the cash flow from assets utilized

Table 2 Descriptive statistics ratios of Nepal Bank Ltd

Year	2019/2020	2018/2019	2017/2018
Sufficiency Ratios			
Cash flow sufficiency	0.718	0.632	0.940
Long term debt repayment	0	0	0
Dividend pay out	0.002	0	0
Reinvestment	0.028	0.586	0.057
Debt cover	13.832	257.500	29.714
Impact of depreciation and write offs	0.013	0.222	0.025
Efficiency ratios			
Cash flow to sales	1.011	0.053	0.415
Operating index	1.624	0.071	0.507
Cash flow on assets	0.061	0.003	0.028

Table 2 presents the sufficiency and efficiency ratios of NBL. Long term debt has not been used and a negligible amount of dividend has been paid during the study period. Cash flow sufficiency and debt cover reveals the cash generating capacity from operation. Operating cash flow from sales and continued activities shows the efficiency of bank to generate cash from operation. Cash flow from operation on assets utilization is increasing.

Table 3 Descriptive statistics ratios of Rastriya Banijya Bank

Year	2019/2020	2018/2019	2017/2018
Sufficiency Ratios			
Cash flow sufficiency	0.947	9.715	0.001
Long term debt repayment	0	0	0
Dividend pay out	0	0	0
Reinvestment	0.018	0.103	1.541
Debt cover	7.430	61.549	7,374.751
Impact of depreciation and write offs	0.007	0.065	10.434
Efficiency ratios			
Cash flow to sales	1.912	-0.223	0.002
Operating index	3.066	-0.290	0.002
Cash flow on assets	0.123	-0.015	1.225

According to table 3 long term debt and dividend have no impact on performance measurement. Debt cover period is decreasing indicates the sufficiency of cash generation from operation. Cash flow sufficiency is increasing shows the ability to generate sufficient cash to meet primary obligations. Operating cash flow from sales and continued activities shows the efficiency of bank during 2019/2020 while it seems weak in 2018/2019 and 2017/2018.

Table 4 Descriptive statistics ratios of Agriculture Development Bank

Year	2019/2020	2018/2019	2017/2018
Sufficiency Ratios			
Cash flow sufficiency	0.454	0.714	0.654
Long term debt repayment	0	0.066	0.202
Dividend pay out	0.474	0.193	0.176
Reinvestment	0.044	0.030	0.101
Debt cover	33.525	17.769	47.773
Impact of depreciation and write offs	0.048	0.024	0.058
Efficiency ratios			
Cash flow to sales	0.284	0.447	0.163
Operating index	0.499	0.767	0.279
Cash flow on assets	0.025	0.046	0.017

According to table 4 the cash flow sufficiency ratio is decreasing in ADB. Long term debt payment and dividend payout ratios shows the sufficiency of operating cash to meet the concerned obligations. Debt cover period is increasing during 2019/2020. Cash flow sufficiency is increasing shows the ability to generate sufficient cash to meet primary requirements. It seems efficient to generate operating cash flow from sales and continued activities. The operational cash generation efficiency from continued activities and asset utilization revealed sound in NBL and RBB than ADB in 2019/2020. However cash flow sufficiency has a similar trend in all banks.

Conclusion

The aim of this paper was to examine and analyze the performance of Nepalese commercial banks through cash flow ratios. This study identified that all the sample banks are efficient to generate operating cash flow from sales and continued activities. Moreover the cash generation efficiency from continued activities and asset utilization revealed sound in NBL and RBB than ADB in 2019/2020. Long term debt repayment and dividend payout has no effect on performance evaluation. The other cash flow sufficiency ratios has a similar trend in all banks. On the basis of different efficiency ratios and sufficiency ratios the performance of Nepalese commercial banks revealed good and lies in the line of Das, (2019).

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