

Negative Working Capital Management of Two-Wheeler Manufacturing Company in India

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Abstract

Indian automobile industry comprises of commercial vehicles, utility vehicles, passenger vehicles, three-wheelers and two-wheelers; of which the two wheeler segment constitutes approx 80% of the total automobile industry with the production of 17 million vehicles in 2013-14. Most intriguing feature of two-wheeler manufacturers is that they work on negative working capital. Their current liabilities are more than their current assets and still they are flourishing at the rate of 12.9% in 2014. This paper attempts to scrutinize the intricacies of working capital management in two-wheeler industry by assessing and comparing annual reports of three giants of two-wheeler manufacturer in India. It is imperative to understand till when the positives of a negative working capital will continue to work for the two-wheeler industry.

Keywords: *automobile, manufacturing, working capital, growth.*

Introduction

India is a manufacturing giant in two wheelers: motorcycles, scooters and mopeds. Last year, two-wheeler makers registered a growth of 13%. Passenger vehicles contracted by 0.8% and commercial vehicles contracted by 6.5%. This contraction can be attributed to high interest rates and the economic slowdown. The automotive industry cumulative grew at 9.8%. The industry is doing well in domestic as well as international markets. India exported around 3.1 million vehicles. Two-wheelers manufacturer is the king of Indian Automotive industry. Top three two wheeler manufactures of nation are: Hero Motocorp, Bajaj Auto Ltd and TVS Motors Ltd.

Hero Motocorp

Munjal brothers of Hero Cycles Ltd and Honda group from Japan entered into a joint venture in 1984 to form Hero Honda Motors Ltd. Their first plant was set up at Dharuhera India. In 2011 Honda group sold its 26% stake in Hero Honda Motors to the Munjals. And Hero Honda Motors Ltd became Hero Motocorp. Presently Hero Motocorp has 3 plants: one at Gurgaon, second at Dharuhera and third Haridwar. Cumulative capacity of all the plants is 30,00,000 bikes per year. The company has a widespread network for marketing, sales and service. It has approximately

above 3000 dealers and centres for service across thenation.The cumulative sales of Hero Motocorp in FY14 were 6115197.

TVS Motor

TVS Motor has its foundation in the entrepreneurial spirit of T.V.S. Iyengar. He pursued his dream in 1911 with first bus service in Madurai and incorporated T.V. Sundaramlyengar and Sons Ltd. The group today has 33 companies under it and has accounted for a cumulative turnover of approximately \$ 3,000,000,000.TVS Motor currently is at number three in two-wheelersproducers list of India and is the main company of TVS group. Annual turnover of TVS motor in 2013-14 is approximately \$ 1.4 billion. The company has three manufacturing locations in India; one in Tamil Nadu at Hosur, second in Himachal Pradesh at Nalagarh and third in Karnataka at Mysore. It also has a plant in Indonesia at Karawang.

Bajaj Auto

Bajaj Auto Ltd is at number two in two wheelers ranking in India. The company is among the leading manufacturer of three wheelers also in the country.Bajaj Auto Ltd is highly recognised for its Research &Development, process engineering, product development, and low-cost manufacturing skills. The company registered export revenue of 18% out of the total revenue. It is leading exporter of three wheelers and two wheelers in the country. Favourite export market for Bajaj is Latin American countries, Middle East, Africa and South East Asia.

Bajaj Auto Ltd is the main driver of the Bajaj Group. The group which was founded in 1930is currently one of the top 10 business houses present in India. In 1965 Rahul Bajaj succeeded Jammalal Baja and took the company to new heights. He is the current chairman of Group.

Working Capital Management

Working capital as the name indicates is the amount of capital required for running a business. Working capital may also be called operating capital, capital required to carry day to day operations of a firm. In accounting, working capital is current assets - current liabilities. It is commonly studied to analyze overall health of a firm; it measures efficiency, profitability and liquidity of a firm.Working capital requirement is based on several factors like: size and nature of the business, credit policy: credit allowed and credit availed, length of operating cycle, operating efficiencies, banking facilities, business cycle, level of competition, seasonal variations and etc.Negative working capital means having more of current liabilities than current assets. It is a good thing for business which have high turnover.Two things to check in order to analyse if the negative working capital is good for the firm are: a) the liabilities are short term accounts payable and not the long term debt and b) the firm has enough free cash flow for that period to cover the short-term liabilities. If both of the above terms are met, there is no disturbing situation for the firm.

Literature Review

(Amarjit Singh, 2012). Indian automobile industry has grown drasticallyand various joint venture has taken place post 1991 reforms and these ventures have shaped the automobile industry of India. It is one of the main industries in manufacturing sector and provides employment direct as well indirect to millions of people in the nation. This paper further tells what are the main products of the industry and there market segments. Swot analysis is done; trend analysis is also depicted in this paper. It tells what will be the future technological demands in this industry are and how India should use its potential and maintain competitiveness in this industry. The industry has a wide scope in domestic as well international market and the industry should tap this opportunity.

(Dr.S.Kalaiyarasi, 2014)In this paper Dr. S. Kalaiyarasi studied working capital management strategies of Indian automobile industry with the help of few companies. It is well

known that automotive industry of India is of the major contributor to India's GDP. And is the emerging sector and contributes majorly in the balance of trade of nation. In past few years it has grown at the rate of 18%. Working capital was studied because it is directly related to day to day operations of a firm. Management of working capital is careful planning of current assets and its deployment to support operations of the firm. It is directly related to profitability of the firm. This part of total capital is also known by different terms like revolving capital or operational capital. Companies studied under this paper were Hero Motors, Mahindra group, Tata group, Ashok Leyland, Hyundai Motors, Bajaj Auto and Yamaha Motors Ltd. Study suggested there is a considerable relation working capital and inventory of a firm. Further cost control measures should be adopted and machines and manpower should be utilized optimally. **(S.Sujatha, 2014)** This paper was a clear focus on working capital management of TVS motors Ltd for five years from FY 2008 to year 2013. After Hero Motocorp and Bajaj, it is third largest two-wheeler producer in the nation. TVS group has more than 30 companies under its umbrella. Ratio analysis was done to study the efficiency of operational capital. The study concluded that the ratios were not satisfactory. Further Mrs. Sujatha suggests that the firm should curtail its overheads and improve its solvency and liquidity. Moreover, the firm is using more of funds from debts than from shareholder's equity. **(Arora, 2014)** This paper studied the concept of how negative working capital can be beneficial for some firms. We know in the present era of tough competition, a firm must cut down its cost in order to survive. And majority of the cost in any firm is its operational cost. Capital required for sustaining this operational cost is termed as working capital. With changing time, some companies are exploring the option of surviving in negative working capital. The paper studied TVS motors for a period of 8 years, from 2002 till 2010. Further it was found that entire can be divided into two phases, one in which company had positive working capital and the other in which it had negative working capital. Company's performance was analysed under these two phases and effort was made to compare these performances. The paper tries to analyse whether performance or profitability of the firm was affected by negative working capital, and also which phase was better for the firm: negative working capital phase or positive working capital phase. It was concluded that the phase of negative working capital was better for firm's performance.

Research Methodology

Research Design: Descriptive research design has been used for the current study. Descriptive research design means to describe the characteristic or behavior of the subject under study. **Data Collection:** Secondary data has been used for this study. Required data is obtained from official Annual report published by the company in last 5 years.

Analysis of data: Secondary data collected is analyzed through various financial ratios. Comparative and trend analysis is done of the data. This data is depicted in graphical form for easy comparisons and finding out the trend.

Objectives behind the study are:

- To study working capital management and its importance in manufacturing firms
- To study the trend of negative working capital followed in two wheeler industry
- To study how far this trend will continue and what are the benefits of this trend
- To analyze balance sheet of three giants in two wheeler industry and study the working capital management technique by these firms

Limitation of the study

- This study is specific to two-wheeler industry of India.
- It may not be applicable to two-wheeler manufacturer outside India.

- Study includes only 3 two-wheeler manufacturer companies of India.
- Study is done for five years- 2009 to 2014.

Analysis

Balance sheet analysis for companies is done for past 5 years. It is analyzed in 2 ways: a. trend lines and b. Ratios. Trend lines are generally used for revenues, net profits, gross margin, accounts receivable, debt and cash. Ratios are used for detail understanding of a company's position. There are various types of ratios used for different purposes: liquidity ratios, activity ratios/ turnover ratios / efficiency ratios, profitability ratios, leverage ratios and valuation ratios. In the study conducted both trend line and ratios are used.

Analysis of Hero Motocorp:(5-Year performance 2009-14)

1. Key profitability ratios:

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Profit After Tax (in crores)	2232	1928	2378.1	2118.2	2109.1
Return on Cap Employed %	75.1	52.1	49.8	48.6	51.4
Gross Profit Margin %	16.1	11	10.8	9.2	9.6
Return on Net Worth %	64.4	65.2	55.4	42.3	37.7
Net Profit Margin %	14	9.9	10	8.8	8.2

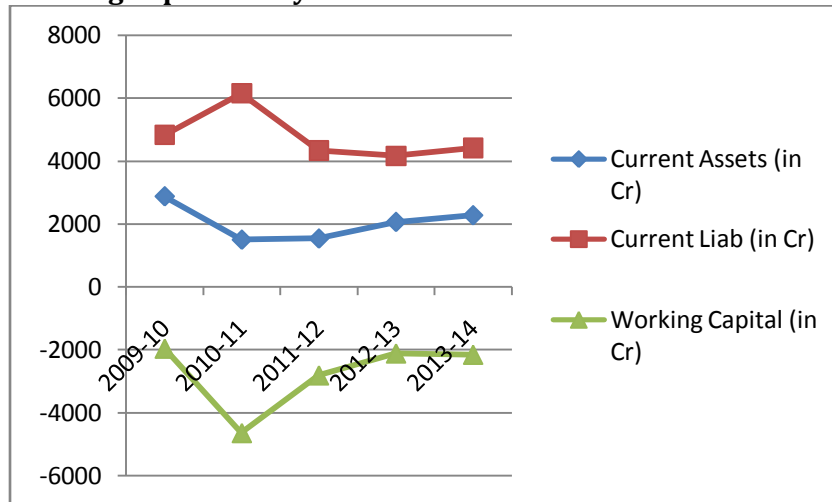
2. Key Liquidity Ratios:

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Quick Ratio	0.5	0.15	0.3	0.5	0.46
Current Ratio	0.6	0.24	0.4	0.7	0.6
Debt Equity Ratio	0.02	0.5	0.2	0.06	-

3. Key Working Capital/ Efficiency Ratios:

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Inventory Period (in days)	8.5	8.3	8.9	9.7	9.6
Debtor Turnover Ratio	122.6	162.1	117.1	50.7	31.9
Asset Turnover Ratio	4.3	4.8	4.85	4.5	4.6
Inventory Turnover Ratio	42.8	43.9	41	37.3	37.8

Working Capital Analysis



Analysis of Bajaj Auto Ltd

1. Key profitability ratios:

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Profit After Tax (in crores)	1703.63	3339.7	3004	3043.57	3241.95
Return on Cap Employed %	59	68	64	53	48
Gross Profit Margin %	20	19	18.4	17.4	19.5
Return on Net Worth %	58	68	50	38.5	33.8
Net Profit Margin %	14	20	15	15	15.6

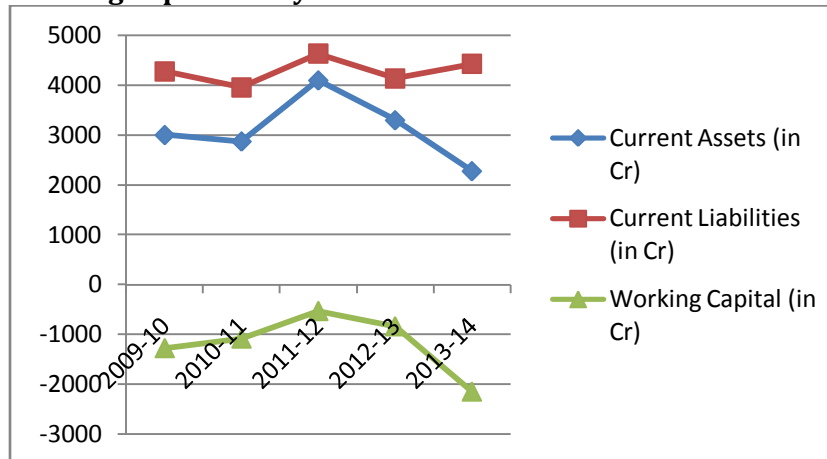
2. Key Liquidity Ratios:

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Quick Ratio	0.5	0.7	0.7	0.74	0.7
Current Ratio	0.7	0.8	0.9	0.9	0.8
Debt Equity Ratio	.5	.071	.02	.01	.01

3. Key Working Capital/ Efficiency Ratios:

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Inventory Period (in days)	12.6	11.12	11.78	11.61	11.58
Debtor Turnover Ratio	37.4	51.8	50	33.6	25.3
Asset Turnover Ratio	3.1	3.5	3.4	2.8	2.1
Inventory Turnover Ratio	28.9	31	31	31.4	31

Working Capital Analysis



Analysis of TVS Motors Ltd

1. Key profitability ratios:

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Profit After Tax (in crores)	88.1	195	249.2	116.1	262
Return on Cap Employed %	9.8	18.4	19.8	17.1	20
Gross Profit Margin %	2.4	3.2	4.9	3.9	4.4
Return on Net Worth %	10.5	19.5	21.3	9.5	18.5
Net Profit Margin %	2	3.1	3.5	1.6	3.3

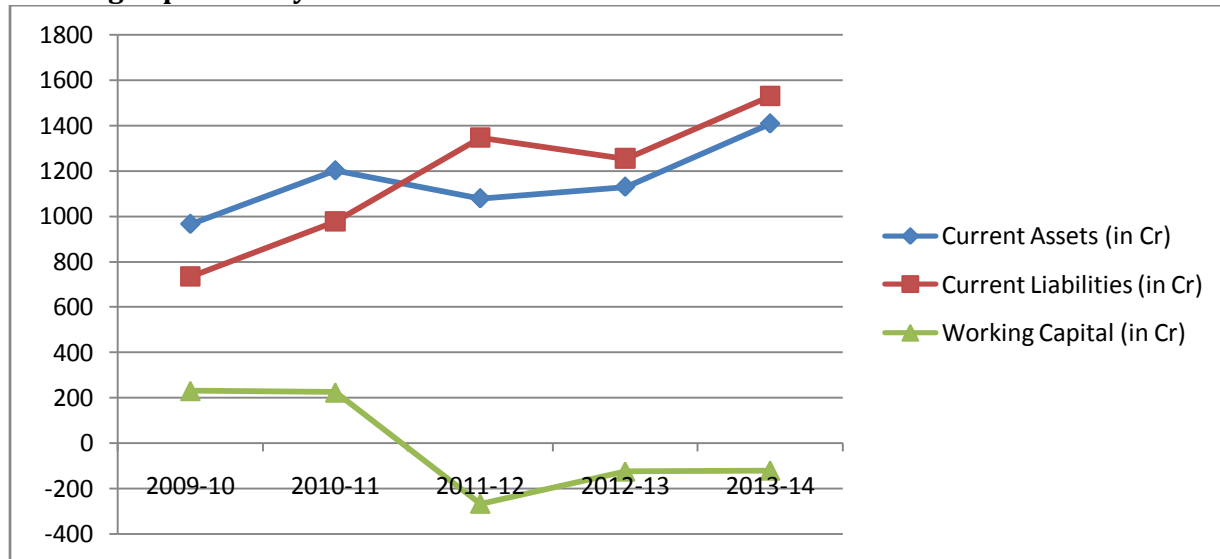
2. Key Liquidity Ratios:

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Quick Ratio	0.76	0.6	0.4	0.5	0.6
Current Ratio	1.14	1.1	0.7	0.8	0.9
Debt Equity Ratio	1.2	0.8	0.6	0.5	0.34

3. Key Working Capital/ Efficiency Ratios:

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Inventory Period (in days)	21.3	27.5	29.9	26.3	25.3
Debtor Turnover Ratio	21.7	25.2	28.2	26.4	25.1
Asset Turnover Ratio	2.4	3.4	3.9	3.9	4.4
Inventory Turnover Ratio	17.1	13.3	12.2	13.9	14.5

Working Capital Analysis



Results and Conclusion

Hero Motocorp had negative working capital throughout the years under study. For last two years its negative working capital has remained around Rs 2100 Cr. Inventory period for Hero Motocorp remained around 9 days for all the years under study. Inventory turnover ratio is 38, which is pretty good. Current ratio and Acid test ratios are below 1 for past five years. Debtor turnover ratio for Hero Motocorp was highest in 2010-11, 162.1. For 2013-14 debtors turnover ratio is 31.9. Asset turnover ratio is around 4.6 for years under study. Gross profit margin also declined over the years, currently it is 10% and net profit margin is 8%. Return on capital employed is approximately 50% and return on net worth is 38%.

Bajaj Auto Ltd also had negative working capital throughout the years under study. Inventory period for Bajaj auto remained around 12 days for all the years under study and inventory turnover ratio is 31%. Debtor turnover ratio declined in last two years. It was highest in 2010-11, 52%, currently it is 25%. Asset turnover ratio also declined over the years, currently it is 2%. Both current ratio and quick ratio of Bajaj auto is 0.7. Gross profit margin is 19% and net profit margin is 15%. Profit margin declined in last two years. Return on capital employed is 48% and return on net worth is 33.8%. Return on net worth also declined over the years. Debt to equity ratio came down to 0.01 in 2013-14.

TVS motors had positive working capital unlike its competitors, in 2009-10 and 2010-11. But from 2011-12, TVS motors also followed suit and had a negative working capital from FY 2011-12 and it continued in 2013-14. The company had negative working capital of Rs. -120.4 crores in 2013-14. Inventory period for TVS motors remained around 25 days for all the years under study and inventory turnover ratio is around 14.5%. Debtor turnover ratio for TVS is good, 25%. Asset turnover ratio is approximately 4%. Current ratio of TVS is 0.9 and quick ratio of TVS motors 0.6. For all the five years under study, current ratio for TVS was above 1 in 2009-10 and also in 2010-11. Debt to equity ratio declined to 0.4. It was 1.2 in 2009-10. Gross profit margin is 4% and net profit margin is 3%. It is less compared to its competitor's. Return on capital employed in 2013-14 is 20%, which is highest in all five years. Return on net worth is 18.5%.

Conclusion

From the study, it can be concluded that negative working capital is not always bad. It is a sign on managerial efficiency. All the top three players of two-wheeler automobile industry are working on negative rotational capital. Not only two-wheeler industry but also many other well established brands are now working on negative working capital. This trend is soon catching up firms where the firms have good bargaining power; credit period given to a firm is more than the debtor period given by the firm. Also in firms which have high inventory turnover ratio. The biggest reason of negative working capital in two-wheelers is that they have high credit period and also that they collect advances from the customers. People pay advance money for booking two-wheeler. Also the credit period enjoyed by these companies are high. Credit goods given to these companies are reflected as T P in the balance sheet of companies, and therefore their current liabilities is more than current assets. The inventory ratio for these firms is high, making their inventory period low. That means they have to keep stocks for less days as their stock converted into sales quickly, hence create quick revenue for them. This extended days; difference between days given by creditors and days in which they receive money from sales, is a support system for firms. In a way they are able to fund their operations from other's money. It means that the current assets of the firm are being financed through the current liabilities the firm has. Also if the firm is very efficient, it can leverage these difference in days and invest the money for short term to earn additional income.

This trend will continue in the two-wheeler industry till the free cash flow is available to face the short term liabilities of the firm. In case it fails to do so, the firm may be in deep financial trouble and might be heading towards insolvency. Two wheeler manufacturers have a preference towards this trend because of its various advantages, below is the list of advantages of having negative working capital:

- It is low cost financing of current assets. It saves interest cost by financing current assets through current liabilities. The extent of benefit under this will vary depending on company to company.
- It is a good indicator of operational efficiency and also managerial efficiency.
- It leads to higher profitability since the cost of working capital is low for firms working on negative operational capital.
- It can be regarded as quick realization of cash. In numerous industries customers make advance payments, and the suppliers have a longer due date, thus the cash conversion cycle of such businesses is negative.
- It can be leveraged as an alternate source of short term investments, which can be an added source of earnings for the firm. The amount received from the customer can be invested for short-term instead of paying o supplier because of the flexible credit norms. These companies earn an additional sum of money apart from other benefits like saving on interest cost.

Despite of various benefits of negative working capital, a firm should check its inventories, account payables and free cash flow from time to time for better interpretation.

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