WORKING CAPITAL MANAGEMENT WITH SPECIAL REFERENCE TO VARDHMAN TEXTILES LIMITED

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ABSTRACT

Working Capital plays a very important role in the success of any commercial organisation. Working capital is that capital which is required for day to day functioning of the organisation. Theoretically, working capital is defined as the difference between the current assets and current liabilities of the firm. Current assets are those assets which can be converted into cash within a period of one year. Current Liabilities are the liabilities which have to be paid within a period of one year. In the present study an attempt has been made to analyse the working capital management of Vardhman Textiles Ltd. The study covers a period of five years i.e. 2008-2009 to 2012-2013. The analysis has been done through ratio analysis, correlation and ANOVA.

Keywords: Working Capital, Current Assets, Current Liabilities, Liquidity, Profitability.

INTRODUCTION

Working Capital: Working Capital is that capital which is required for the day to day functioning of the organisation. The working capital is needed for purchase of raw materials, meeting the various production expenses such as wages, energy charges, financing book debts etc. In simple terms working capital means the difference between current assets and current liabilities.

Working Capital is rightly called the life blood of the business. If a company does not have sufficient amount of working capital, if will jeopardise its function. Without sufficient working capital the company will not be able to make timely payment to its suppliers and workers. It will not be in a position to dictate its terms while purchasing the raw materials and other consumables. Not only this, it will also make a dent in the goodwill of the company. So, working capital plays a vital role in the success of any commercial organisation. The level of the working capital should be optimum i.e. neither too low nor too high.

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CONCEPTS OF WORKING CAPITAL

There are two concepts of working capital-gross and net.

- **Gross Working Capital** refers to the firm's investment in current assets. **Current Assets** are the assets which can be converted into cash within an accounting year and include cash, short-term securities, debtors (accounts receivable or book debts), bills receivable and stock (Inventory).
- **Net working capital** refers to the difference between current assets and current liabilities. Current Liabilities are those claims of outsiders which are expected to mature for payment within an accounting year and include creditors (accounts payable), bills payable, other current liabilities, short term provisions and outstanding expenses. Net working capital can be positive or negative. A positive net working capital will arise when current assets exceed current liabilities. A negative net working capital occurs when current liabilities are in excess of current assets.

  The two concepts of working capital-gross and net- are not exclusive; rather, they have equal significance from the management viewpoint.

Focusing on Current Assets Management

The gross working capital concept focuses attention on two aspects of current assets management: (1) How to optimize investment in current assets? (2) How should current assets be financed?

The consideration of the level of investment in current assets should avoid two danger points-excessive and inadequate investments in current assets. Investment in currents should be just adequate to the needs of the business firm. Excessive investment in current assets should be avoided because it impairs the firm's profitability, as idle investment earns nothing. On the other hand, inadequate amount of working capital can threaten the solvency of the firm because of its inability to meet its current obligations. It should be realized that the working capital needs of the firm may be fluctuating with changing business activity. This may frequently cause excess or shortage of working capital. The management should be prompt to initiate an action and correct imbalances.

Another aspect of the gross working capital points to the need of arranging funds to finance current assets. Whenever a need for working capital funds arises due to the increasing level of business activity or for any other reason, financing arrangement should be made quickly. Similarly, if suddenly, some surplus funds arise they should not be allowed to remain idle, but should be invested in short-term securities. Thus the financial manager should have the knowledge of the sources of the working capital funds as well as investment avenues where idle funds may be temporarily invested.

Focusing on Liquidity Management

Net working capital is a qualitative concept. It indicates the liquidity position of the firm and suggests the extent to which the working capital needs may be financed by permanent sources if funds. Current assets should be sufficiently in excess of current liabilities to constitute a margin or buffer for maturing obligations, within the ordinary operating cycle of the business. In order to protect their interests, short-term creditors always like a company to maintain current assets at a higher level than current liabilities. It is a convention rule to maintain the level of current assets twice the level of current liabilities. However, the quality of current assets should be considered in determining the level of current assets vis-à-vis current liabilities. A weak liquidity position poses a threat to the solvency of the firm and makes it unsafe and unsound. A negative working capital means a negative liquidity, and may prove to be harmful for the company's reputation. Excessive liquidity is also bad. It may be due to the mismanagement of currents assets. Therefore, prompt and timely action should be taken by the management to improve and correct the imbalances in the liquidity position of the firm.

The net working capital concept also covers the question of judicious mix of long-term and short-term funds for financing the current assets. For every firm, there is a minimum amount of the working capital which is permanent. Therefore, a portion of the working capital should be financed with the permanent sources of funds such as equity share capital, debentures, long-term debt, preference share capital or retained earnings. Management must, therefore, decide the extent to which current assets should be financed with equity capital and or/borrowed capital.

REVIEW OF LITERATURE

Ghosh and Maji, (2003): in their paper made an attempt to examine the efficiency of working capital management of the Indian cement companies during 1992 – 1993 to 2001 – 2002. For measuring the efficiency of working capital management, performance, utilization, and overall efficiency indices were calculated instead of using some common working capital management ratios. Setting industry norms as target-efficiency levels of the individual firms, this paper also tested the speed of achieving that target level of efficiency by an individual firm during the period of study. Findings of the study indicated that the Indian Cement Industry as a whole did not perform remarkably well during this period.

Amit, Mallik, Debashish and Debdas (2005): in their study regarding the relationship between working capital and profitability of Indian pharmaceutical industry found and concluded that no definite relationship could be established between liquidity and profitability.

Vishanani and Shah (2007) studied the impact of working capital management policies on corporate performance of Indian consumer electronic industry by implemented simple correlation and regression models.

Lyroudi and Lazardis (2000) investigated the cash conversion cycle and liquidity position of the food industry in Greece. They used cash conversion cycle as a liquidity level indicator of the food industry in Greece and tried to determine its relationship with the traditional liquidity measurement and profitability measurement of return on investment, return on equity and net profit margin. They found significant positive relationship between cash conversion cycle and current ratio, quick ratio, receivables conversion period and inventory conversion period and negative relationship between cash conversion cycle and payable deferred period. The relationship between liquidity measurement variable and profitability measurement variables were not statistically significant and there was no relationship between cash conversion cycle and leverage ratio.

Bhunia (2007) studied liquidity management of public sector Iron and Steel enterprise in India. He has found that the actual values of working capital lower than the estimated value of working capital for both companies under study and poor liquidity position in case of both companies.

Van Horne and Wachowicz (2004) mention that excessive level of current assets may have a negative upshot of a firm's profitability, while a low level of current assets may escort to lowers of liquidity and stock-outs, resulting in difficulties in maintaining smooth operations. Problem in working capital management is to accomplish desired tradeoff between liquidity and profitability

Deloof, (2003): discussed that most firms had a large amount of cash invested in working capital. It can therefore be expected that the way in which working capital is managed will have a significant impact on profitability of those firms. Using correlation and regression tests he found a significant negative relationship between gross operating income and the number of days accounts receivable, inventories and accounts payable of Belgian firms. On basis of these results he suggested that managers could create value for their shareholders by reducing the number of days' accounts receivable and inventories to a reasonable minimum. The negative relationship between accounts payable and profitability is consistent with the view that less profitable firms wait longer to pay their bills.

OBJECTIVES:

1. To analyze the firm‘s efficiency in Working Capital Management through Ratio Analysis

2. To analyze the relationship between Working capital management efficiency and profitability of Vardhman Textiles Ltd.

Data Collection

In the present study, the secondary data has been used. The data is collected from the annual reports of the company.

Scope of the Study

The study covers a period of 5 year i.e. 2006-07 to 2010-11 and is just confined to Vardhman Textiles Ltd.

Research Tools and Techniques

The research tools used in this study are Ratio Analysis and Correlation.

Objective 1: To analyze the firm‘s efficiency in Working Capital Management through Ratio Analysis

In order to achieve this objective the various ratios as given below have been calculated:

Data Analysis

Table 1

Table Showing Components of Current Assets of Vardhman Textile Ltd.

(Rs. in crores)

Year	**2007**	**2008**	**2009**	**2010**	**2011**
Current Investments	0.00	0.00	0.00	0.00	134.41
Inventories	695.85	870.36	620.10	1107.46	1598.39
Trade Receivables	252.41	274.70	275.67	397.34	489.58
Cash and Cash Equivalents	216.73	62.70	357.21	222.07	48.74
Short-Term Loans and Advances	499.29	621.01	673.53	676.88	436.09
Other Current Assets	0.00	0.00	0.00	0.00	17.87
Total Current Assets	**1664.20**	**1828.77**	**1926.52**	**2403.75**	**2725.08**

Source: Annual Reports of the company

Analysis and Interpretation: The Table 1 above shows that there is a continuous increase in the current assets of the company. The current assets have increased from Rs. 1664.20 in 2007 to Rs. 2725.08 crores in the year 2011. There is an addition of current investments to the tune of Rs. 134.41crores in the year 2011. The inventories have increased to Rs. 1598.39 crores in the year 2011 as compared to Rs. 1107.46 crores in the year 2010. This is not a very good sign as the money is blocked in inventories.

Table 2

Table Showing Com

Components of Current Liabilities of Vardhman Textile Ltd.

(Rs. in Crores)

Year	**2007**	**2008**	**2009**	**2010**	**2011**
Short-Term Borrowings	225.15	323.63	351.28	459.39	864.68
Trade Payables	110.78	88.50	58.69	54.32	83.21
Other Current Liabilities	169.08	158.05	180.34	193.97	305.74
Short-Term Provisions	260.41	307.99	317.19	385.93	38.35
Total	**765.42**	**878.17**	**907.49**	**1093.61**	**1291.98**

Source: Annual Reports of the company

Analysis and Interpretation: It can be seen from the Table 2 above that the current liabilities of the company have been increasing at a steady rate. The current liabilities which were at Rs. 765.42 crores in the year 2007 have touched a figure of Rs. 1291.98 crores in the year 2011. From the table 2 above it is clear that Short-Term Borrowings of firm have increased by Rs. 405 crores which needs to be further analysed.

Table 3
Net Working Capital of Vardhman Textiles Ltd.

(Rs. in Crores)

Year	**2007**	**2008**	**2009**	**2010**	**2011**
Current Assets	1664.42	1828.77	1926.52	2403.75	2725.08
Current Liabilities	765.42	878.17	907.49	1093.61	1291.98
Net Working Capital	**899.00**	**950.60**	**1019.03**	**1310.14**	**1433.10**

Source: Annual Reports of the company

Analysis and Interpretation: It can be seen from the Table 3 above that Net Working Capital of the company has been increasing every year. However, in the year 2010 it has increased to Rs. 1310.14 crores as compared to Rs. 1019.03 crores in the year 2009. In all the remaining years has increased at a steady rate.

Table 4
Current Ratio of Vardhman Textiles Ltd.

(Rs. in Crores)

Year	**2007**	**2008**	**2009**	**2010**	**2011**
Current Assets	1664.42	1828.77	1926.52	2403.75	2725.08
Current Liabilities	765.42	878.17	907.49	1093.61	1291.98
Current Ratio	**2.17**	**2.08**	**2.12**	**2.20**	**2.11**

Source: Annual Reports of the company

Analysis and Interpretation: It is clear from the Table 4 that company is maintaining a very good current ratio in all the years under study. The company is maintaining a current ratio in the range of 2.08 to 2.20. This ratio is as per the convention of 2:1.

Table 5
Quick Ratio of Vardhman Textiles Ltd.

(Rs. in Crores)

Year	**2007**	**2008**	**2009**	**2010**	**2011**
Quick Assets	1126.69	1296.29	1306.42	958.47	968.57
Current Liabilities	765.42	878.17	907.49	1093.61	1291.98
Quick Ratio	**1.27**	**1.09**	**1.44**	**1.19**	**0.87**

Source: Annual Reports of the company

Analysis and Interpretation: The Table 5 above shows that from 2007 to 2010 the company has maintained a good quick ratio i.e. above 1. However, in the year 2011 there has been a sudden fall in the quick ratio and it has slipped to below 1. This is the year in which there was huge increase in the inventory of the company. The company needs to look into this as it requires detailed analysis.

Objective 2: To analyze the relationship between Working capital management efficiency and profitability of Vardhman Textiles Ltd.

In order to achieve this objective, the correlation between liquidity and profitability has been calculated using SPSS. The two variables for liquidity are current ratio (CR) and quick ratio (OR). The profitability has been measured as return on assets (ROA) (%).

Table 6
Current Ratio, Quick Ratio and ROA of Vardhman Textiles Ltd.

Year	2007	2008	2009	2010	2011
Current Ratio	2.17	2.08	2.12	2.20	2.11
Quick Ratio	1.27	1.09	1.44	1.19	0.87
ROA (%)	4.97	2.87	3.15	4.39	8.97

Source: Annual Reports of the company

Table 7
Correlation between Current Ratio, Quick Ratio, and Return on Assets

		Current Ratio	Quick Ratio	Return on Assets (%)
Current Ratio	Pearson Correlation	1	.309	.012
	Sig. (2-tailed)		.613	.985
	N	5	5	5
Quick Ratio	Pearson Correlation	.309	1	-.739
	Sig. (2-tailed)	.613		.154
	N	5	5	5
Return on Assets (%)	Pearson Correlation	.012	-.739	1
	Sig. (2-tailed)	.985	.154	
	N	5	5	5

Source: Author's Calculations

Analysis and Interpretation: It is clear from the Table 7 above that correlation between current ratio, quick ratio and return on assets is not at all significant. So, it can be concluded that there is no significant relationship between liquidity and profitability of the firm.

Findings of the Study:

From this study it can be concluded that company is maintaining a good current ratio i.e. it is between 2 and 2.5 during the period of the study. The company is efficiently managing its current assets. However, during the year 2011, there has been an exceptional increase in the inventory of the company which needs to be looked into. With the increase in the inventory, the quick ratio of the company has also come down to 0.87 in that year. The correlation between liquidity and profitability shows no relationship.

Limitations of the Study: The main limitation of the study is that it covers only one company and the period covered is five years.

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