EFFECIENCY OF WORKING CAPITAL MANAGEMENT ON COPORATE PROFITABILTY

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ABSTRACT

This study aims to examine the effects of working capital management on profitability in the context of Indian fast moving consumer goods (FMCG) firms. Working capital management is considered to be an important issue in a firm's overall financial management decision and it has both liquidity and profitability implications. The sample size for this study is restricted to 3 Indian FMCG firms listed on the NIFTY Index in the Bombay Stock Exchange (BSE) and the secondary data for analysis is retrieved from Money Control and Stock Axis for the five-year period from 2013-14 to 2017–18. The result shows that there is no significant relationship between working capital management and profitability.
Keywords: Working Capital Management, FMGC, Liquidity, NIFTY, BSE

INTRODUCTION

Working Capital Management is an important component of Corporate Financial Management. It is the relationship between current assets and current liabilities. Management of working capital is important to carry the routine activities of a firm. The objective behind working capital management is to ensure continuity in the operations of a firm and that it has enough funds to satisfy both maturing short-term debt and upcoming operational expenses. It mainly involves management of inventories, accounts receivables, accounts payables and cash. Working capital management involves planning and controlling current assets and current liabilities in a manner that eliminates the risk of inability to meet short term obligations on the one hand and avoid excessive investment in these assets on the other hand. The basic theme of working capital management is to provide adequate support for smooth and efficient functioning of day to day business operations by striking a trade between the three proportions of working capital. They are liquidity, profitability and risk.

Working capital management is a vital issue in financial decision making since it is a part of investment in asset and it directly affects the liquidity and profitability of the company. However, working capital always is disregarded in financial decision making since it involves investment and financing in short term period. The main scope of the study is to check the management of working capital (current assets and current liabilities) of FMCG sector. This study analyses the liquidity position and working capital management of a limited sample consisting of only 3 companies from the FMCG Sector. The study of working capital is based on the tool i.e. Ratio Analysis. Further the study is based on last 5 years Annual Reports of the 3 companies taken into consideration. As only FMCG sector was studied so the findings could only be generalized to this sector's firms. Study of the working capital management is very crucial for all the firms. Unless the working capital is planned, managed and monitored effectively, company cannot earn profits and increase its turnover. Also, it helps in removing bottlenecks. Although various studies have been conducted on analyzing the working capital management of Indian companies but very few studies have measured the working capital management of top FMCG companies over the recent 5 years. This study bridges the gap and highlights the status of working capital management of top 3 FMCG companies in India which were chosen from NIFTY.

REVIEW OF LITERATURE

1. Evaluating the Impact of Working Capital Management Components on Corporate Profitability: Evidence from Indian Manufacturing Firms

   Dr. Sarbapriya Ray

   The study tries to investigate the relationship between working capital management components and the profitability of a sample of Indian manufacturing firms using a sample of 311 Indian manufacturing firms for a period of 14 years. The effect of different variables of working capital management including the average collection period, inventory turnover in days, average payment period, cash conversion cycle and current ratio, debt ratio, size of the firm and financial assets to total assets ratio on the net operating profitability of Indian firms. The result suggests a strong negative relationship between the measures of working capital management including the number of days accounts receivable and cash conversion cycle, financial debt ratio with corporate profitability.
2. Impact of Working Capital Management on Profitability

   Hina Agha

   The main purpose of this study is to test the impact of working capital management on profitability. To investigate this relationship between these two, the author collected secondary data from Glaxo Smith Kline pharmaceutical company registered in Karachi stock exchange for the period of 15 years. For this purpose, in this study they use variable of return on assets ratio to measure the profitability of company and variables of account receivable turnover, creditors turnover, inventory turnover and current ratio as working capital management criteria. The results of the research show that there is a significant impact of the working capital management on profitability of company. So, the results indicate that through proper working capital management the company can increase its profitability.

3. Sensitivity of profitability to working capital management: a study of Indian corporate hospitals

   Mohammad Talha ,S. Benjamin Christopher

   The study focuses on the impact of working capital management on profitability of selected Indian corporate hospitals. The time span is ten years. The results of regression analysis point out that the current ratio, cash turnover ratio, proportion of current assets to operating income and leverage have a negative influence on profitability. Stepwise regression analysis has identified seven prominent variables that significantly influence profitability. Path analysis reveals that 'quick ratio' has the highest direct effect on profitability, while 'current ratio' has the least direct effect.

4. Working capital management and profitability: Evidence from Indian manufacturing companies

   Monica Singhania Navendu Sharma , J. Yagnesh Rohit

   The study examines the relationship between working capital management strategies of a firm and its profitability. They try to understand the impact of the global macroeconomic conditions on this relationship. They apply correlation analysis and fixed effects estimation on their sample of Indian manufacturing companies. Cash conversion cycle has been utilized as a measure of the working capital management, whereas gross operating profit is used as a proxy for a firm's profitability. The results reveal that cash conversion cycle of a company has a negative correlation with its profitability. Their results also suggest that managers can improve the performance by decreasing the number of days receivables and increasing the number of days payables. The findings highlight the importance of efficient working capital management practices to improve the profitability of companies.

5. Evaluating Relationship of Working Capital and Profitability: A Study of Select Multinational Companies in the Indian Pharmaceutical Sector.

   Sur, Debasish; Chakraborty, Kaushik

   This study seeks to re-examine the interrelationship between working capital management and profitability of ten select multinational companies in the Indian pharmaceutical industry for a period of 10 years. The selection of the companies has been made using purposive sampling procedure. Relevant statistical techniques and tests have been applied in carrying out the analysis. The study has failed to provide final solution to this highly controversial topic.

6. Managing Efficiency and Profitability Through Working Capital: An Empirical Analysis of BSE 200 Companies
   Harsh Vineet Kaur and Sukhdev Singh
   The study analyses the working capital performance of 164 manufacturing BSE 200 companies classified into 19 industries for 10 years based on working capital calculated by using values of Cash Conversion Efficiency, Days Operating Cycle and Days Working Capital. The study explores abundant scope to increase the efficiency of 145 companies by improving the parameters of analysis. The results of the study support earlier studies revealing that efficient management of working capital significantly affects profitability.

RESEARCH DESIGN

Objectives of the Study:

1. To understand the relationship between different components of working capital and profitability.
2. To study the impact of components of working capital on firm's profitability

Research Methodology and Data Collection:

Financial Ratio data sourced from moneycontrol.com and stockaxis.com of FMCG companies listed on the NIFTY Index has been used for the analysis of working capital levels and its effects on profitability. Various ratios and the subsequent profitability over the past 5 years have been calculated for the selected companies.

The scope of the study is limited to 3 Indian FMCG firms namely ITC, Hindustan Unilever and Jubilant Foodworks listed on the NIFTY index in the Bombay stock exchange as on 31st March 2018, these companies are studied over a 5-year period. (2013-2018).

Hypothesis 1:

(H0): There is no significant relationship between the components of working capital and profitability.

(H1): There is a significant relationship between the components of working Capital and profitability.

Hypothesis 2:

(H0): There is no significant influence of working capital on profitability.

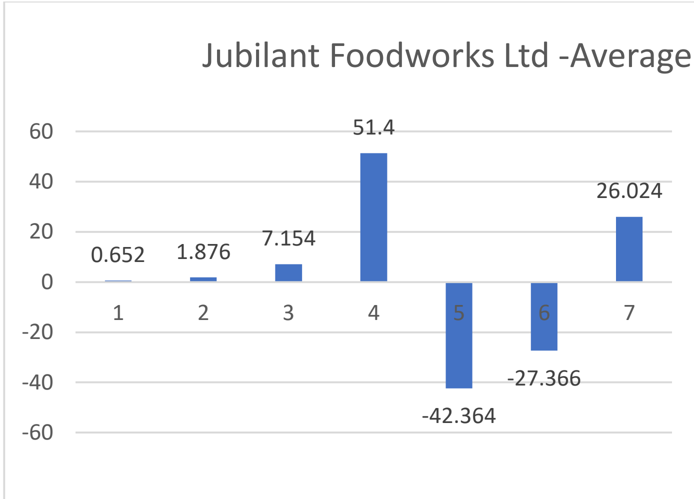
(H1): There is a significant influence of working capital on profitability.

DATA ANALYSIS AND INTERPRETATION

- **JUBLIANT FOODWORKS**

YEAR	CURRENT INVESTMENT	INVENTORY	TRADE RECEIVABLES	CASH AND CASH EQUIVALENT	LOANS AND ADVANCES	OTHER CURRENT ASSETS	TOTAL CURRENT ASSETS	TOTAL CURRENT LIABILITY	NET WORKING CAPITAL
2013-14	144.04	366.86	53.69	65.78	229.69	0	860.06	633.05	227.01
2014-15	387.9	345.74	70.98	186.67	438.01	0	1429.3	791.54	637.76
2015-16	343.63	384.01	106.7	24.8	558.25	0	1417.39	850.62	566.77
2016-17	85.73	602.61	126.41	53.55	791.94	344.64	2004.88	914.94	1089.94
2017-18	735.48	594.58	230.32	97.25	820.41	289.48	2767.52	1194.98	1572.54
AVERAGE	339.356	458.76	117.62	85.61	567.66	126.824	1695.83	877.026	818.804

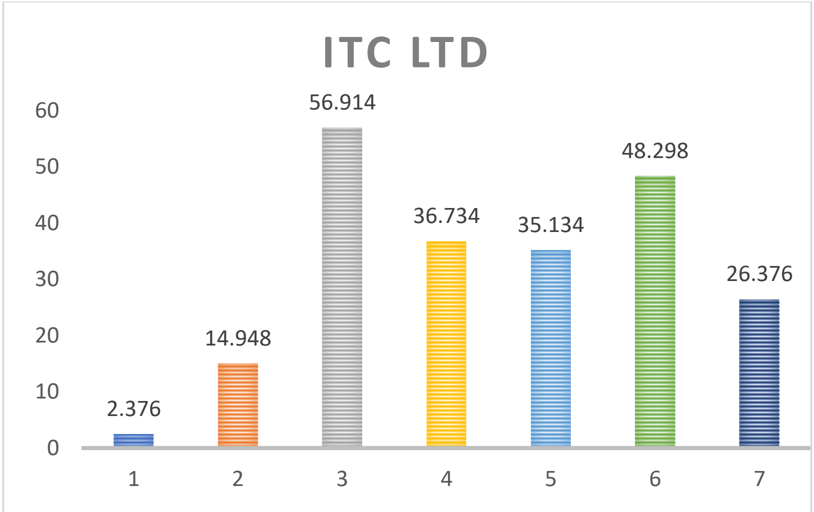
YEAR	CURRENT RATIO	RECEIVABLE DAYS	INVENTORY DAYS	PAYABLE DAYS	Cash Conversion Cycle	Working Capital Days	RETURN ON CAPITAL EMPLOYED (%)
2013-14	0.64	1.8	6	43.28	-35.47	-16.02	36.79
2014-15	0.54	1.82	6.66	48	-39.51	-24.64	27
2015-16	0.56	1.82	7.37	52.82	-43.62	-22.52	20.88
2016-17	0.68	2.02	8.19	55.26	-45.05	-43.54	11.26
2017-18	0.84	1.92	7.55	57.64	-48.17	-30.11	34.19
AVERAGE	0.652	1.876	7.154	51.4	-42.364	-27.366	26.024



- **ITC LTD**

YEAR	CURRENT INVESTMENT	INVENTORY	TRADE RECEIVABLES	CASH AND CASH EQUIVALENT	LOANS AND ADVANCES	OTHER CURRENT ASSETS	TOTAL CURRENT ASSETS	TOTAL CURRENT LIABILITY	NET WORKING CAPITAL
2013-14	6311.26	7359.54	2165.36	3289.37	783.51	1019.89	20928.93	5619.61	15309.32
2014-15	5963.82	7836.76	1722.4	7588.61	549.89	293.56	23955.04	5575.82	18379.22
2015-16	6461.34	8519.82	1686.35	6563.95	501.84	401.44	24134.74	6269.27	17865.47
2016-17	10,099.78	7863.99	2207.5	2747.27	3.37	1615.48	24537.39	6788.24	17749.15
2017-18	9903.45	7237.15	2357.01	2594.88	4.15	2406.36	24503	8817.36	15685.64
AVERAGE	7747.93	7763.452	2027.724	4556.816	368.552	1147.346	23611.82	6614.06	16997.76

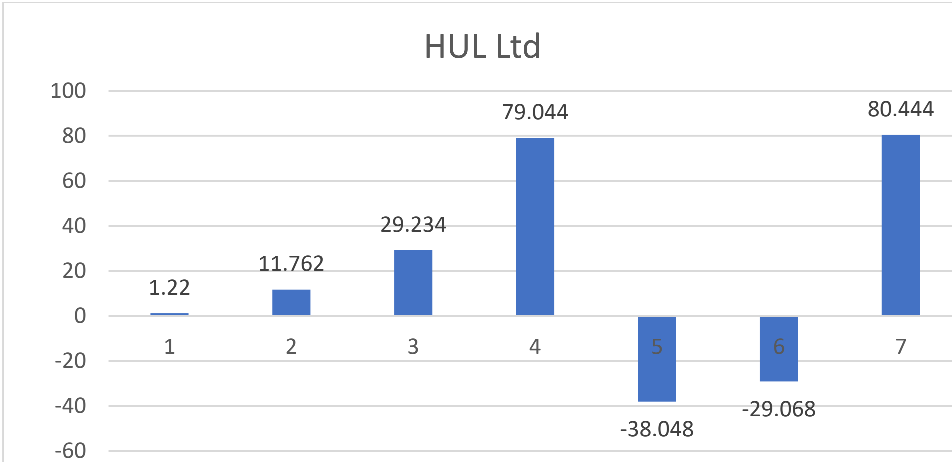
YEAR	CURRENT RATIO	RECEIVABLE DAYS	INVENTORY DAYS	PAYABLE DAYS	CASH CONVERSION CYCLE	Working Capital Days	RETURN ON CAPITAL EMPLOYED (%)
2013-14	1.82	13.26	54.68	32.82	35.13	37.96	31.68
2014-15	2.05	15.18	57.82	32.77	40.23	74.1	29.54
2015-16	1.65	12.92	58.72	35.13	36.51	48	28.18
2016-17	3.59	13.65	53.61	37.01	30.26	53.18	21.52
2017-18	2.77	19.73	59.74	45.94	33.54	28.25	20.96
AVERAGE	2.376	14.948	56.914	36.734	35.134	48.298	26.376



- **HINDUSTAN UNILIVER**

YEAR	CURRENT INVESTMENT	INVENTORY	TRADE RECEIVABLES	CASH AND CASH EQUIVALENT	LOANS AND ADVANCES	OTHER CURRENT ASSETS	TOTAL CURRENT ASSETS	TOTAL CURRENT LIABILITY	NET WORKING CAPITAL
2013-14	2457.95	2747.53	816.43	2220.97	537.68	71.91	8852.47	6646.83	2205.64
2014-15	2623.82	2602.68	782.94	2537.56	657.27	59.28	9263.55	6196.95	3066.6
2015-16	2461	2528	1064	2759	0	740	9530	6362	3168
2016-17	3519	2362	928	1671	0	885	9365	6815	2550
2017-18	2855	2359	1147	3373	0	1405	11139	7985	3154
AVERAGE	2783.354	2519.842	947.674	2512.306	238.99	632.238	9630.004	6801.156	2828.848

YEAR	CURRENT RATIO	RECEIVABLE DAYS	INVENTORY DAYS	PAYABLE DAYS	Cash Conversion Cycle	Working Capital Days	RETURN ON CAPITAL EMPLOYED
2013-14	1.03	11.93	33.46	72.32	-26.93	-36.35	88
2014-15	1.05	10.91	31.16	72.29	-30.22	-32.52	88.95
2015-16	1.43	11.95	29.29	77.48	-36.24	-13.25	56.92
2016-17	1.3	11.96	26.81	82.85	-44.08	-33.73	81.82
2017-18	1.29	12.06	25.45	90.28	-52.77	-29.49	86.53
AVERAGE	1.22	11.762	29.234	79.044	-38.048	-29.068	80.444



FINDINGS AND SUGGESTIONS

1. In the case of Jubilant Foodworks Ltd. We notice that there is a negative cash conversion cycle which indicates managerial efficiency since the management uses the receipt from the customers to finance its daily activities. We also notice negative working capital days that is essentially negative working capital and that it does not significantly affect the ROCE and it remains positive at 26.024%.
2. In the case of ITC Ltd we notice that both the cash conversion cycle and working capital days are positive. Positive Cash Conversion Cycle indicates that the company uses short term debt to finance its routine activities. Positive Working Capital does not significantly pull up the Return on Capital Employed by a significant margin. The average of the positive five years of cash conversion cycle and working capital days does not significantly pull up the ROCE and inversely it decreases over the 5 years averaging 26.376%.
3. In the case of Hindustan Unilever Ltd. We notice again that they maintain a negative cash conversion cycle and working capital days. The negative cash conversion cycle means that the company finances itself through its receipts from customers and hence a trend is seen in increasing the negative cash conversion cycle. Negative working capital days and ROCE in this case do not show any significant relation with decreasing ROCE (decrease as per theories) except in the 3rd year when the working capital days are the least negative the ROCE dips the most and subsequently increases as the negativity of the working capital days increases.
4. The negative NWC had been persistently supported by the leading FMCG companies in India namely, Jubilant Foodworks Ltd. and HUL for their daily operations.
5. The inventory in absolute terms is showing decreasing trend which is directly contributing in the fall of working capital. Low debt collection period indicates at the efficiency of the company that effectively contributes to the decline in its working capital.

CONCLUSION

Negative working capital days and negative cash conversion cycle is preferred by FMCG companies so that the cost of borrowing to finance the working capital can be reduced. The negative working capital can be attributed to collection of money from customers at a faster speed as compared to the payments made to the creditors and the efficiency with which these companies sell their products. Another reason here is that the terms regarding the decision of time for receivables and payables can be dictated by these leading FMCG companies.

According to our study there is no significant relationship between return on capital employed and working capital days. Our results contradict the conventional theory which states that negative working capital days has an adverse impact on the observations of the companies.

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