Analysis of the investment in current assets to understand the trade-off between liquidity and profitability- (A study on Sun Mobility Pvt Ltd)

Author 01

Mr. Lokesh K N
Sr Assistant Professor, MBA Dept, New Horizon College of Engineering, Bangalore

Author 02

Miss Rakshitha S
Student, MBA Dept, New Horizon College of Engineering, Bangalore

Abstract:

In today's blistering world, any industry or a firm prefer to be at the top most position by earning sufficient profits. For the company to be in profit liquidity also plays a major role since the equilibrium between the liquidity and profitability is very much important. Any discrepancies in the investment of current assets, disturbs both liquidity and profitability and as a result company can go with bankruptcy. Here, in this paper we will analyze the investment in current assets to understand the trade-off between liquidity and profitability of Sun Mobility Pvt Ltd. Tradeoff between liquidity & profitability is analyzed

Keywords: Current Assets, Discrepancy, Equilibrium, Liquidity, Profitability.

INTRODUCTION

Effective working capital management is expected to contribute well to build a strong value. Funds are responsible for ensuring that firms meet their short-term obligations and that their ongoing flow can be guaranteed from a business. This requires that the business be conducted efficiently and effectively. Normally firms focus on profitability more than the liquidity, but the financial managers should always strike the balance between both. The method of working capital management will have a significant impact on tradeoff between liquidity & profitability. Firms can make use of current asset effectively only with the help of working capital management tool. This tool helps firms to maintain sufficient cash flow to meet day to day operation and as well as avoid dead capital. Liquidity balances the short-term capacity of an organization to meet its developing obligations and to address unforeseen financial problems and productivity balances payments or to achieve organizational performance within a specified time frame.

In the process, the uncertainty of an asset liability may occur which may increase the company's profits over time but at risk of revenue. On the other hand, focusing too much on money sales will be for profit. Too high or too low investment in current assets is not favorable to the company because high liquidity company cannot concentrate on profits and expansion programs will be on hold and too low liquidity company cannot run the business and pay its short-term debts. In this context a study is conducted on Sun Mobility Pvt Ltd to analysis current asset and its impact on liquidity and profitability.

Review of literature

1. **Dr. Pramil kumar and Puneet Saluja (2012)** devised about the profitability and liquidity concepts by expressing that they are like two ends of the straight line, when we move toward one end other part is affected simultaneously. Their study at Airtel Bharti Limited says that any company to increase its profits must keep the liquidity low.
2. **Alwin Irawan, Taufik Faturohman (2015)** is the research study about liquidity and profitability of capital market. They say what would be the result of high and low liquidity. The liquidity will lead to low profitability and vice versa which would affect the paying off debts and investment in production activities.
3. **Dr.(smt). A.N Tamragundi, Puroshottam N Vaidya (2016)** did their research study in FMCG companies about profitability and liquidity components. The study was to know about the interconnection between the two aspects which turned out to be positive with their tests in the 10 leading FMCG companies in India.
4. **Mohmad Mushtaq Khan, Dr. Syed Khaja Safiuddin (2016)** research paper says about the performance of liquidity and profitability of the telecom industries. The research says that there is a vast difference between the performance of liquidity and profitability which is proved with the financial reports of Bharti Airtel Limited and Vodafone company.
5. **Muhammad Nabeel, Sobia Muhammad Hussain (2017)** research paper say how liquidity affects profitability in the banks and also the study shows that liquidity is an independent variable and profitability is a dependent variable. If bank is aiming at higher profitability, then it must have favorable relationship with liquidity.
6. **Gulshan Kumar, Dr. Manoj Upreti (2017)** in the research paper of the company idea cellular limited say that if the firm is in good capacity of converting current assets to liquidity, then they would have high profits and hence there is dissentious relationship between both the aspects.
7. **Dr. K V Ramana Reddy (2018)** is a research study in the software company. The study is been built to comprehend liquidity which helps in profitability. It says if the cash position is low then the company would be in profits and vice versa. The study proves that there is unfavorable relationship between the two and the reason for this would be working capital management.
8. **Binay Shrestha (2018)** studies about liquidity and profitability of commercial banks. The study majorly focuses on resolving the disputes arising from shareholders who need profit and customers in need of liquidity on demand. The study suggests that any bank should have liquidity management to have more profits.
9. **Dusica Srbinoska (2018)** this study was undertaken to know whether there exists an affirmative relationship between the profitability and liquidity of non-financial entities. The research says it is not good if a company has high liquidity or too low liquidity. The key pillars of the study were current ratio, quick ratio, ROE, and ROA which proves that there exists a favorable relationship between the two components.
10. **Tanmayananda Chattaraj, Atul Krishna Kharma, Prabhav Saraf (2019)** have done their research in the e-commerce field. Their study was to check the reasonableness of the theory of trade-off. They say that the inventory was the reason to have dissenting relationship between liquidity and profitability and since most of the e-commerce have zero inventory there exists a negative relationship between the two.

OBJECTIVE OF THE STUDY:

To recognize the relation between the liquidity and profitability of the firm **Sun Mobility Pvt Ltd**

Hypothesis

Null hypothesis: There is no significant relationship between the liquidity and profitability trade-off and the investment.

Alternative hypothesis:There is a significant relationship between the liquidity and profitability trade-off and the investment.

RESEARCH METHODOLOGY:

Research type	Exploratory research
Data source	Secondary data
Research instrument	3 years balance sheet of the company.

- **SAMPLE SIZE:**

  The research is based on the 3 years balance sheet of the company.

- **TOOLS OF ANALYSIS:**
- Applied T-test to identify the differences between the variables in the same or two different population

Limitations of the study

1) Study time is short and limited only in Bangalore.

2) The study and analysis are based on figures from the organization's annual three-year report only.

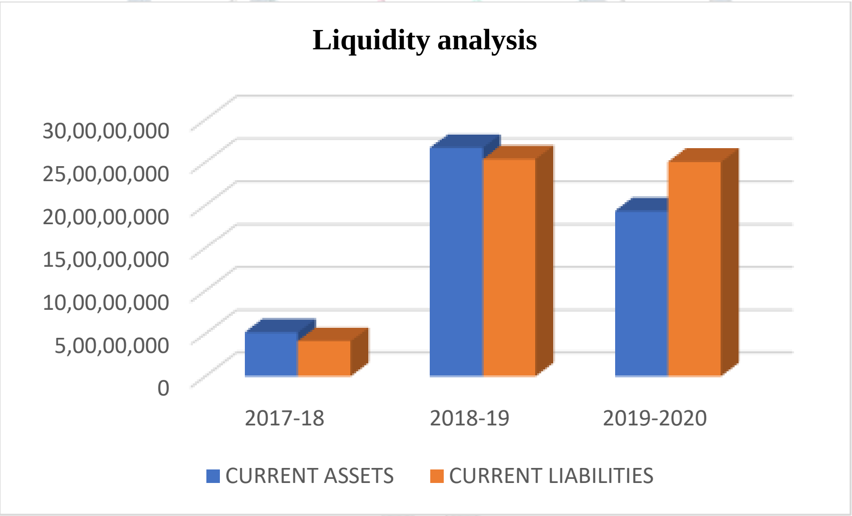
3) Many facts and data such as that should not be disclosed because of the same privacy.

Analysis:

Liquidity analysis

YEAR	CURRENT ASSETS	CURRENT LIABILITIES	CURRENT RATIO CA/CL	WORKING CAPITAL CA-CL
2017-18	5,15,32,097	4,14,16,850	1.24	1,01,15,247
2018-19	26,70,71,275	25,36,41,676	1.05	1,34,29,599
2019-2020	19,33,04,143	25,04,25,006	0.77	(5,71,20,863)

Based on the above calculations we can say that the company capacity to pay off its debts is quite good in first 2 years but poor in the last year. The ideal current ratio is 2:1.



Profitability Analysis

YEAR	CURRENT ASSETS	FIXED ASSETS	TOTAL ASSETS	CURRENT LIABILITY	CAPITAL EMPLOYED (TA-CL)	EBIT	ROEC (EBIT/CE)
2017-18	5,15,32,097	44,841,768	9,63,73,865	4,14,16,850	5,49,57,015	2,14,20,229	38.97
2018-19	26,70,71,275	8,67,89,398	35,38,60,673	25,36,41,676	10,02,18,997	4,15,70,984	41.48
2019-20	19,33,04,143	11,42,92,030	30,75,96,173	25,04,25,006	5,71,71,167	(3,96,02,813)	(69.27)

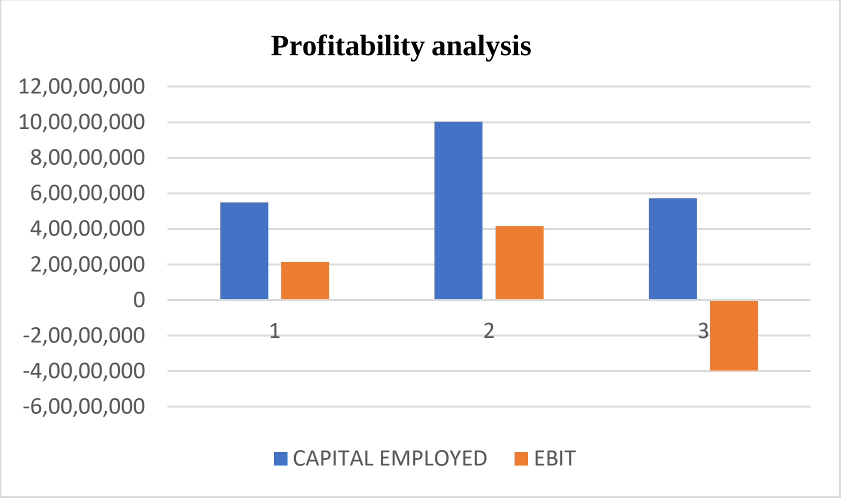
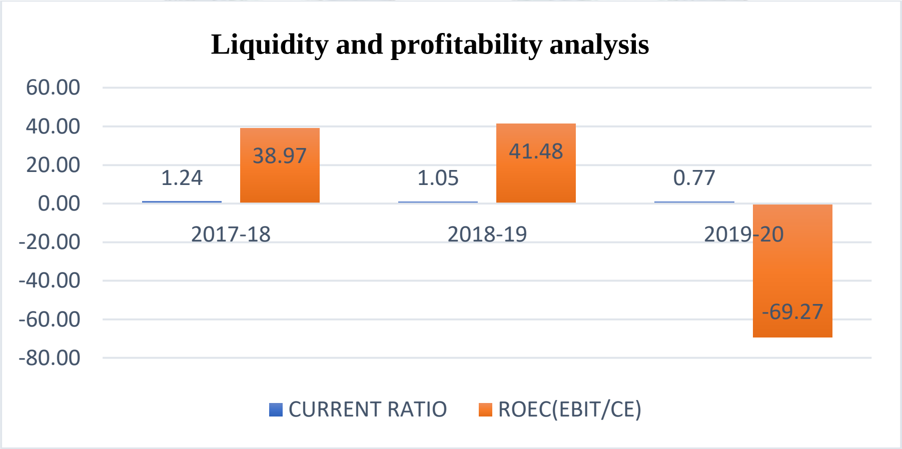


Chart showing liquidity and profitability analysis



Based on the above analysis we can see that the company was in a good position in the first 2 years but the working capital, EBIT, ROEC falls down to negative and the main reason behind this is, in the year 2019-20 the company had more investments in the tangible assets and hence there was no more cash left to run the business and if the current ratio is less than 1 it means the current liabilities is more than current assets and hence all three falls negative.

Relationship between liquidity and profitability

(Spearman's Rank Correlation Method)

YEAR	CURRENT RATIO	RANK(R1)	ROEC	RANK(R2)	DIFFERENCE(D) (R1-R2)	D^2
2017-18	1.24	1	38.97	2	-1	1
2018-19	1.05	2	41.48	1	1	1
2019-20	0.77	3	(69.27)	3	0	0
					TOTAL	**2**

$R = 1 - 6\Sigma D^2 / n^3 - n$

$=1-6(2) / 3^3-3$

$=1-12/24$

$=1-0.5=0.5$

R=0.5

t-test analysis

T test analysis $r = r \sqrt{n-2} / \sqrt{1-r^2}$

$=0.50 \times \sqrt{3-2} / \sqrt{1-(0.50)^2}$

$=0.50 \times \sqrt{1} / \sqrt{1-0.25}$

$=0.50/0.8660$

=0.5773

At 5% level of significance

T = n-2

=3-2

=1

12.71=t

From the above calculations we can see that our computed value is less than the table value and hence we fail to reject null hypothesis due to the insufficient data.

CONCLUSION

It is difficult to maintain equilibrium between liquidity and profitability and companies with urge to make profits continue to operate with negative working capital and make profits and this is known as managerial efficiency but the financial experts say that in long-term by default, they would face the risk and the only way to earn profits is from operations i.e., by paying short-term and long-term expenses. Hence it is recommended for companies to have balance between the liquidity and profitability.

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