INTERNATIONAL JOURNAL OF RESEARCH IN COMPUTER APPLICATION & MANAGEMENT

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APPRAISAL OF LIQUIDITY PERFORMANCE IN LANCO INDUSTRIES LIMITED: A CASE STUDY

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ABSTRACT

Ratios help to summarize large quantities of financial and to make qualitative judgment about the firm's financial performance. The parties interested in financial analysis are short-term and long-term creditors, owners and management. Short-term creditors' gives priority in the liquidity position or the short-term solvency of the firm. Liquidity refers to the ability of the firm to meet the current financial obligations in the short run, usually in one year. To analyze the firm's liquidity position by using the liquidity ratios. The liquidity of the Lanco Industries Limited is analyzed with the help of the following liquidity ratios. The present research paper tries to focus on liquidity performance on Lanco Industries limited and also the paper is endeavoring to analyze on two dimensional passion of liquidity and actual liquidity performance of a Lanco Industries Limited as well. The working funds in current assets were unnecessarily blocked up. The management of current assets and current liabilities was not as per the principles of sound financial management in Lanco Industries Limited. More working capital funds were unnecessarily blocked up in quick assets during the years 2009 and 2010. The liquidity was impairing in last two years of the study as the ratio was far less than that of the ideal norm of 1:1.The cash balances of Lanco Industries Limited had never touched the ideal norm as specified. The management of Lanco Industries Limited would fail to maintain adequate cash balances to meet the currently maturing obligations fully. The current liabilities were not fully discharged out of cash flows Lanco Industries Limited had not generated adequate cash flows to cover the current liabilities as the standard is cent percent cash flow coverage. The cash flow coverage was very thin in Lanco Industries Limited. The working funds which were blocked up unnecessarily in current assets shall be managed for productive purpose based on the sound cannons of working capital management. The adequate cash balances shall be maintained to meet the current obligations, so as to maintain the strong liquidity performance. The management of Lanco Industries Limited has to generate the cash flows by cutting down the costs to cover the current liabilities by maintaining actual liquidity position.

KEYWORDS

Current ratio, Quick ratio, Cash ratio and Net cash flow to current liabilities ratio in Lanco Industries Limited.

INTRODUCTION

Ratio analysis is a powerful tool of financial analysis. A ratio is defined as "the indicated quotient of two mathematical expressions" and as "the relationship between two or more things." In financial analysis, a ratio is used as a bench mark for evaluating the financial position and performance of a firm. The relationship between two accounting figures, expressed mathematically, is known as a financial ratio (or simply as a ratio). Ratios help to summaries large quantities of financial and to make qualitative judgment about the firm's financial performance. The parties interested in financial analysis are short-term and long-term creditors, owners and management. Short-term creditor's gives priority in the liquidity position or the short-term solvency of the firm. Liquidity refers to the ability of the firm to meet the current financial obligations in the short run, usually in one year. To analyze the firm's liquidity position by using the liquidity ratios. These ratios are generally based on the relationship between current assets and current liabilities. The liquidity of the Lanco Industries Limited is analyzed with the help of the key Liquidity ratios.

OBJECTIVES

The present research paper tries to focus on liquidity performance on Lanco Industries limited and also the paper is endeavoring to analyze on two dimensional fashion of liquidity performance i.e., an actual liquidity performance of a LIL.

TOOLS OF ANALYSIS

The data drawn from the annual reports of Lanco Industries Limited have been carefully analyzed, tabulated and interpreted by using well established financial tools. The analysis of data is carried out through liquidity ratios such as current ratio, quick ratio, cash ratio and Net cash flow to current liabilities ratio. Graphs and diagrams are presented to illuminate the facts and figures.

SCOPE AND COVERAGE

The present study is confined to Lanco Industries Limited(LIL). The Lanco Industries Limited, Chittoor District, Andhra Pradesh, India has been selected because of the proximity to the investigator. The study is restricted to assess the performance of Liquidity position in LIL with the help of the ratio analysis. The limited period considered for evaluating the study is seven years i.e. from 2006-2012.

ANALYSIS OF LIQUIDITY

A firm is able to meet its obligations as and when they become due. Liquidity ratios measure the ability of the firm to meet its current obligations (liabilities). The failure of a company to meet its obligations due to lack of sufficient liquidity, will result in a poor credit worthiness, loss of creditors` confidence, or even in legal tangles resulting in the closure of the company. A very high degree of liquidity is also bad; idle assets earn nothing. The firm's funds will be unnecessarily tied up in current assets. Therefore, it is necessary to strike a proper balance between high liquidity and lack of liquidity. The most common ratios, which indicate the extent of liquidity or lack of it, are:

- Current ratio
- Quick ratio
- Cash ratio
- Net cash flow to current liabilities ratio

CURRENT RATIO

Current ratio indicates the quality coverage of current assets over current liabilities. It indicates the ability of the company to meet its maturing current obligations. It is also the reflection of a static condition and of a relationship on one date between two variables. Current assets include cash within a year, such as cash and bank balances, marketable securities, inventories of raw materials, semi finished and finished goods, debtors, bills receivables and pre-paid expenses. Current liabilities are short-term measuring obligations to be met within a year, it includes trade creditors, bills payable, bank credit, provision for taxation, dividends payable and outstanding expenses.

The current ratio is a measure of the firm's short-term solvency i.e., its ability to meet short-term obligations. It indicates the availability of current assets in rupees for every one rupee of current liability. A current ratio of 2:1 is considered satisfactory. The higher the current ratio is the greater the margin of safety; the larger the amount of current assets in relation to current liabilities, the more the firm's ability to meet its obligations. It is a quick measure of the firm's liquidity.

CURRENT RATIO = CURRENT ASSETS/ CURRENT LIABILITIES

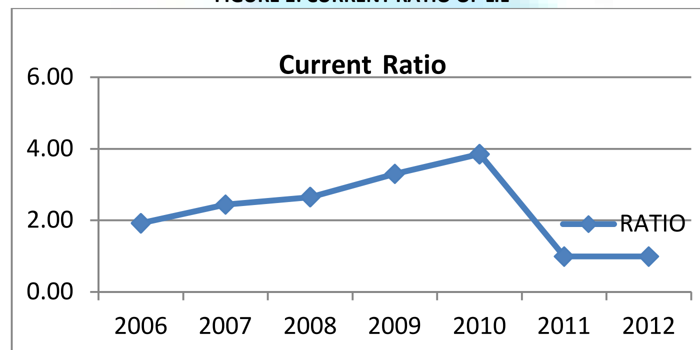
The current ratio of the Lanco Industries Limited is presented in the
Table1 and Figure1.

TABLE 1: CURRENT RATIO OF LIL

Year	Current Assets (Rs. in crores)	Current Liabilities (Rs. in crores)	Ratio (in times)
2006	*183.27*	*95.56*	*1.92*
2007	*262.01*	*107.26*	*2.44*
2008	*266.16*	*100.3*	*2.65*
2009	*359.74*	*108.83*	*3.30*
2010	*304.62*	*79.21*	*3.85*
2011	*490.29*	*493.95*	*0.99*
2012	*566.48*	*568.73*	*0.99*
Mean	***347.51***	***221.98***	***2.30***
Standard Deviation	***13.15***	***212.65***	***1.08***
C.V.(%)	***39.18***	***95.80***	***46.96***
Co-efficient of Correlation 0.92			

Source: Compiled from Annual Reports of Lanco Industries Limited

FIGURE 1: CURRENT RATIO OF LIL



The firm's current ratio refers that the company's short-term solvency. It is obvious that the current assets had moved from Rs.183.27crores in 2006 to Rs. 566.48 crores. There had been gradual increase in the quantum of current asset with an exception of 2010 over the period under the study. Similarly current liabilities had steeply increased from near Rs.9.56 crores in 2006 to Rs.568.73 crores with variations during the period under reference. It is noticed that the current ratio had varied from the lowest of 0.99 times in the last two years to the highest of 3.85 in 2010. The behavior of current ratio was erratic over the study period. The current ratio was well below than the standard norm of two times in two out of seven years of study. The average current ratio registered at 2.30 times. The average current assets and current liabilities in absolute values recorded at 347.51crores and 221.98 crores respectively. The average current assets quantitative figures had exceeded the current liabilities. The standard deviation of current ratio registered at 1.08, while coefficient of variation stood at 46.96. The average co-efficient of correlation was 0.92. It indicates that there is highly positive correlation between current assets and current liabilities.

QUICK RATIO

Quick ratio, also called acid-test ratio, establishes a relationship between quick, or liquid, assets and current liabilities. It indicates the ability of the company to meet its immediate liabilities out of its quickly realizable current assets. An asset is liquid if it can be converted into cash immediately or reasonable soon without a loss of value. Cash is the most liquid asset and other assets that are considered to be relatively liquid. Inventories are considered to be less liquid. The term quick assets refer to current assets excluding prepaid expenses and inventories. Quick ratio is a more penetrating test of liquidity than the current ratio, yet is should be used cautiously. Generally a quick ratio of 1:1 is considered to represent a satisfactory current financial condition. A company with a high value of quick ratio can suffer from the shortage of funds if it has slow-paying, doubtful and long duration outstanding debtors. A low quick ratio may really be prospering and paying its current obligation in time. The quick ratio is found out by dividing quick assets by current liabilities.

QUICK RATIO = CURRENT ASSETS- INVNETORIES / CURRENT IABILITIES

(OR)

QUICK RATIO = QUICK ASSETS/ CURRENT LIABILITIES

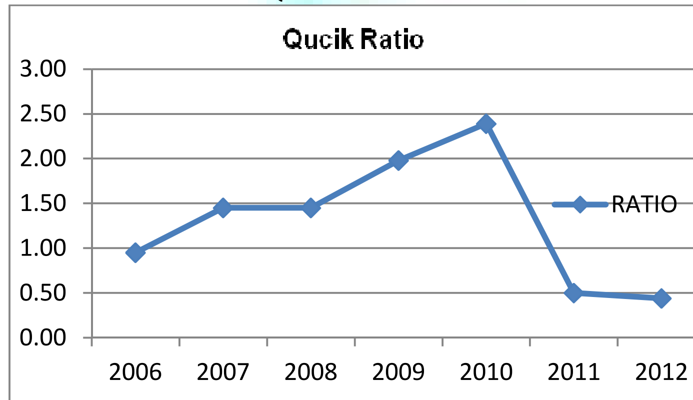
The quick ratio of the Lanco Industries Limited is presented in the
Table 2 and Figure 2

TABLE 2: QUICK RATIO OF LIL

Year	Quick Assets (Rs.in crores)	Current Liabilities (Rs.in crores)	Ratio (in times)
2006	*91.33*	*95.56*	*0.95*
2007	*155.6*	*107.26*	*1.45*
2008	*145.23*	*100.3*	*1.45*
2009	*215.38*	*108.83*	*1.98*
2010	*189.43*	*79.21*	*2.39*
2011	*251.56*	*493.95*	*0.50*
2012	*247.71*	*568.73*	*0.44*
Mean	***185.18***	***221.98***	***1.30***
Standard Deviation	***58.48***	***212.65***	***0.73***
C.V.(%)	***31.58***	***95.80***	***56.15***
Co-efficient of Correlation 0.74			

T Source: Compiled from Annual Reports of Lanco Industries Limited

FIGURE 2: QUICK RATIO OF LIL



The higher the Quick ratio indicates the ability of a firm is liquid and has the ability to meet its current liabilities in time. It is evident that the quantum of quick assets reported the rise during the period under reference. The quick assets had increased from Rs.91.33 crores to Rs.247.71crores in 2012 with mild fluctuations. Current liabilities had abnormally increased from Rs.95.56 crores to Rs.568.73 crores in 2012. The quantum of current liabilities had registered a low amount of Rs.79.21 crores in 2010. The quick ratio of LIL had fluctuated between the lowest of 0.44 times in 2012 to highest of 2.39 times in 2010.The quick ratio had exceeded the standard norm of 1:1 in four years out of seven years under study. It may be further observed that the liquidity was impairing in last two years of the study as the ratio was far less than that of the ideal norm of 1:1. The average quick assets and current liabilities values recorded at 185.18 crores and 221.98 crores respectively. The standard deviation of quick ratio registered at 0.73, while coefficient of variation stood at 56.15. The average co-efficient of correlation was figured at 0.74. It indicates that there is satisfactory positive correlation between quick assets and current liabilities.

CASH RATIO

Cash ratio establishes relation between cash and current assets. It indicates the proportion of cash in current assets. Since cash is the most liquid asset, a financial analyst may examine cash ratio and its equivalent current liabilities. Trade investment or marketable securities are equivalent of cash; therefore, they may be included in the computation of cash ratio.

CASH RATIO = CASH/ CURRENT LIABILITIES

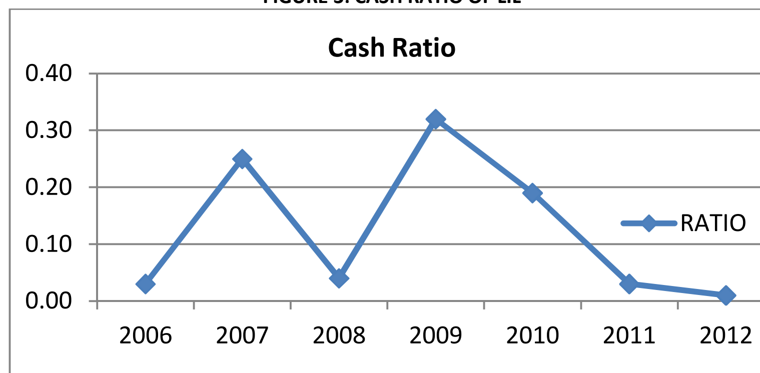
The cash ratio of the Lanco Industries Limited is presented in the
Table 3 and Figure 3

TABLE 3: CASH RATIO OF LIL

Year	Cash (Rs. in crores)	Current Liabilities (Rs. in crores)	Cash Ratio (in times)
2006	*3.56*	*95.56*	*0.03*
2007	*26.54*	*107.26*	*0.25*
2008	*4.20*	*100.3*	*0.04*
2009	*34.64*	*108.83*	*0.32*
2010	*15.16*	*79.21*	*0.19*
2011	*19.16*	*493.95*	*0.03*
2012	*10.24*	*568.73*	*0.01*
Mean	***16.21***	***221.98***	***0.12***
Standard Deviation	***11.52***	***212.65***	***0.13***
C.V. (%)	***71.06***	***95.80***	***108.33***
Co-efficient of Correlation -0.090			

Source: Compiled from Annual Reports of Lanco Industries Limited

FIGURE 3: CASH RATIO OF LIL



High cash ratio indicates the idle cash reserves in the company, but low cash ratio is also not favorable to the company. The quantum of cash had registered a mix trend of rise and fall one a period under study. It had increased from Rs.3.56 crores immediately to Rs.26.54 crores and declined to the lowest level of Rs.4.2 crores. Again it depicted an increase of Rs.34.6 crores in 2009 and declined to Rs.10.24 crores in the concluding year of the study. The cash ratio had exposed to oscillation over the period under reference. The standard cash ratio is 0.5:1. The cash of LIL had never touched the ideal norm as specified. It may be inferred that the management of LIL would fail to maintain adequate cash balances to meet the currently maturing obligations fully. The average cash and current liabilities in absolute values recorded at 16.21 crores and 221.98 crores respectively. The average current liabilities quantitative figures had exceeded the cash. The standard deviation of cash ratio is registered at 0.13, while coefficient of variation stood at 108.33. The average coefficient of correlation was negatively framed at -0.090. It indicates that there is negative correlation between cash and current liabilities.

NET CASH FLOWS TO CURRENT LIABILITIES RATIO

Actual liquidity position of a firm mostly depends on its ability in paying off its current financial obligations from the net cash flows generated form its own operations but not by current assets alone when it is on the run. Irrespective of the source cash is generated from, it definitely provides coverage to the current obligations. Depreciation is non-cash expenses.

NET CASH FLOWS TO CURRENT LIABILITIES RATIO = NET PROFIT
+ NON CASH EXPENSES / CURRENT LIABILITIES X 100

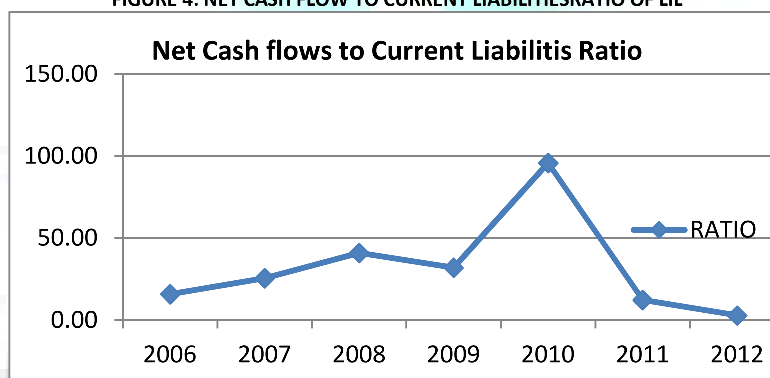
The Net cash flows to current liabilities ratio of the Lanco Industries Limited is presented in the Table 4 and Figure 4

TABLE 4: NET CASH FLOW TO CURRENT LIABILITIESRATIO OF LIL

Year	Net Profit + Non-cash expenses (Rs. in crores)	Current Liabilities (Rs. in Crores)	Ratio (in percentage)
2006	*15.14*	*95.56*	*15.84*
2007	*27.40*	*107.26*	*25.55*
2008	*41.08*	*100.3*	*40.96*
2009	*34.76*	*108.83*	*31.94*
2010	*75.89*	*79.21*	*95.81*
2011	*60.73*	*493.95*	*12.29*
2012	*16.05*	*568.73*	*2.82*
Mean	***38.72***	***221.98***	***32.17***
Standard Deviation	***22.68***	***212.65***	***30.80***
C.V.(%)	***58.57***	***95.80***	***95.74***
Co-efficient of Correlation -0.094			

Source: Compiled from Annual Reports of Lanco Industries Limited

FIGURE 4: NET CASH FLOW TO CURRENT LIABILITIESRATIO OF LIL



It is evident that the net cash flows had increased form Rs.15.41 crores in 2006 to Rs.60.73 crores and sharply edged down to Rs.16.05 crores. The current liabilities had strikingly had jumped from Rs.95.26 crores in 2006 to Rs.568.73 crores in 2012 with the exception of the year 2010. The ratio had widely fluctuated from the lower of 2.82 percent in 2012 to the highest of 95.81 percent in 2010. The cash flow coverage was very less during the period of study excluding the year 2010. It may be inferred that LIL had not generated adequate cash flows to cover the current liabilities as the standard is cent percent cash flow coverage. Hence, the cash flow coverage was very thin in LIL. The average net profit and non-cash expenses and current liabilities recorded at 38.27 crores and 221.98 crores respectively. The standard deviation of net cash flow to current liabilities ratio is registered at 30.80, while coefficient of variation stood at 95.74. The average coefficient of correlation was negatively framed at -0.094. It indicates that there is negative correlation between cash flow and current liabilities.

CONCLUSION

The working funds in current assets were unnecessarily blocked up. The management of current assets and current liabilities was not as per the principles of sound financial management in LIL. More working capital funds were unnecessarily blocked up in quick assets during the years 2009 and 2010. The liquidity was impairing in last two years of the study as the ratio was far less than that of the ideal norm of 1:1.The cash balance of LIL had never touched the ideal norm as

specified. The management of LIL would fail to maintain adequate cash balances to meet the currently maturing obligations fully. The current liabilities were not fully discharged out of cash flows LIL had not generated adequate cash flows to cover the current liabilities as the standard is cent percent cash flow coverage. The cash flow coverage was very thin in LIL. The working funds which were blocked up unnecessarily in current assets shall be managed for productive purpose based on the sound cannons of financial management practices. The adequate cash balances shall be maintained to meet the current obligations, so as to maintain the strong liquidity performance. The management of LIL has to generate the cash flows by cutting down the costs to cover the current liabilities by maintaining actual liquidity position.

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