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WORKING CAPITAL MANAGEMENT AND PROFITABILITY –A CASE STUDY OF BALRAMPUR CHINNI MILLS LIMITED

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ABSTRACT

An accepted financial axiom is that the role of managers is to maximize the wealth by the efficient utilization of resources available to them. The management of Working Capital is one of the most dominant and challenging aspect of the overall financial management. Working Capital has acquired a great significance and sound position for the twin objects of "profitability and liquidity." The efficient working capital management is the most crucial factor in maintain survival, liquidity and profitability of the concerned business enterprise. In this paper an effort has been made to make a case study of Balrampur Chinni Mills Limited for assessing the trend of working capital management and also to suggest an appropriate audit program to facilitate proper working capital management in the Sugar Industry. For the purpose of investigation both primary and secondary data is used. The impact of working capital management on profitability has been examined by computing coefficient of correlation and multiple regression analysis between profitability ratio and some other statistical tools are included for prediction of working capital policy indicator ratios. The result reveals that there is a significance negative relationship between liquidity and profitability.

KEYWORDS

Inventory Management, Indian Sugar Industry, Liquidity Management, Payables Management, Receivables Management, Trend Analysis and, Working Capital Management.

INTRODUCTION



Sugar is more than just a business it is a way of life for a large part of India. The developing countries are normally faced with the problem of inefficient utilization of resources available to them. The importance of working capital to a manufacturing is such that the failure or success of an enterprise is determined by the availability of sufficient working capital. In the global competitive environment, rising capital cost and scare funds, the importance of working capital needs special emphasis. The study of impact of working capital management policies on corporate Performance occupies an important place in financial management. The efficient management of working capital is important from the point of view of both liquidity and Profitability. Liquidity and Profitability are two vital aspects of corporate business life. Liquidity measures the ability of an enterprise to honor all the maturing obligations. No firm can endure without liquidity. Profitability is the rate of return on firm's investment. It is, therefore, essential to maintain an adequate degree of liquidity for smooth running of the business operations. The liquidity should be neither excessive nor inadequate. All the above elements clearly indicate the crucial importance of working capital in management of finance.

COMPANY PROFILE

Indian sugar Industry has a prominent place in the world sugar Industry. Balrampur is one of the India's largest sugars producing company. It ranks amongst the fastest growing sugar mills in the country. BCML, one of the largest sugars manufactures in India's Private sector. Balrampur Chinni Mills Limited (BCML) was incorporated in 1975 under the companies Act as a wholly –owned subsidiary company of Balrampur Sugar Company Limited (Name changed to Balrampur Commercial Enterprises Limited) (BCEL). By an indenture of conveyance dated 21 February 1976, BCEL transferred to BCML the land, building and other assets and the entire staff of its Balrampur sugar factory with effect from 1 July 1975. BCML ceased to be a subsidiary of BCEL with effect from 25 Th June, 1979 and its shares were listed on the Calcutta Stock Exchange in 1979. The Balrampur Mill started with a crushing capacity of 800 TCD (Metric Tonnes Crushed per day) in 1975 and has since been expanded to its present capacity of 76590 TCD. There are nine production units of the company located in India. The company is engaged in the manufacture of sugar, power generation, Industrial –Alcohol, Molasses and Bagasse. BCML has refinery capacity of 500 TCD at its Haidergarh plant and of 700 TCD of the Rauzagaon plant. The capacity of two sub-divisions –(i) Indo –Gulf Industries Ltd, and (ii) Balrampur Overseas Pvt. Ltd. A wholly owned subsidiary incorporated in Hong Kong. BCML has acquired a 53.96 percent stake in the equity capital of Indo-Gulf Industries Ltd. BCML has taken over the management of IGIL after receiving of the approval from SEBI and completion of the open offer. The sugar division of IGIL situated at maizapur, gonad UP has been demerged from IGIL and merged with BCML pursuant to order dated 24.06.2011 of the BIFR apriority rehabilitation scheme of IGIL.

OBJECTIVES OF THE STUDY

This study focuses on the working capital management and profitability. The major objectives of the study can be indentified as hereunder.

- To assess the liquidity Management on profitability in the company.
- To examine the effectiveness of working capital management practices of the company.
- To examine the relationship between liquidity and profitability by using correlation coefficient and to test the significance of such correlation coefficient.
- To examine the impact of the ratio relating to working capital management and profitably with the assistance of correlation coefficient and regression analysis and to test the significance of the regression coefficients.
- To prescribe remedial measures to encounter the problems faced by the company.
- To examine the impact of inventory, debtors and creditors on current assets or profitability of the company.

DATABASE AND METHODOLOGY OF THE STUDY

The data and information required for this study comes in the secondary data. The data has been mainly collected from the Annual Reports, budgets and statistical Reports of the company. Apart from these some of the data has been collected through personal interview and discussions with the concerned executives of the corporate. For analyzing data, statistical techniques like simple regression analysis and multiple regressions are used for analyzing the data. For this empirical study one major private sector sugar industry namely Balrampur Chinni Mills Limited (BCML) has been purposively selected. The study covers a period of 10 years (2001-02, to 2010-2011). The present study is focused on understanding the impact of efficient working capital management on the profitability and liquidity of the company. Further in order to identify the influence of profitability, a linear multiple regression models were used. For this purpose, current ratio (CR), liquid ratio (LR), Working capital Turnover (WTR), Receivable Turnover Ratio (RTR), Creditor's Turnover Ratio (CTR), (all indicators working management policies and practices) have been taken as the independent variables and Profit before tax (PBT) to total assets ratios is taken as dependent variable. However, in the course of analysis, it was found that ITR is highly correlated. Therefore, ITR is removed for the analysis. The model taken was given under.

$PBT/TA = b_0 + b_1CR + b_2LR + b_3WTR + b_4RTR + b_5CTR + b_6WC/TA$

Where $b_0, b_1, b_2, b_3, b_4, b_5$ and b_6 are parameters to be estimated.

KEY OBSERVATIONS AND FINDINGS

The following are the major observations and findings of the study with respect to each component of the working capital of the sample company.

1. WORKING CAPITAL ANALYSIS

Component wise Gross Working Capital and Net Working Capital is exhibited in Table 1.

TABLE- 1: COMPONENTS OF WORKING CAPITAL (Rs. In lakhs)

Year	Cash & Bank	Inventory	Sundry Debtors	Loans & Advances	Other Current Assets	Gross Working Capital	Ratio of CA to TA	Current Liabilities & Provisions	Net Working Capital
2001-02	883.27 (2.68)	28848.9 (87.69)	1289.5 (3.92)	1814.64 (5.52)	61.89 (0.19)	32898.18 (100)	70.14	14911.15	17987.03
2002-03	345.12 (0.95)	30237.3 (82.89)	1522.09 (4.17)	3993.17 (10.95)	376.94 (1.03)	36474.62 (100)	57.42	12854.03	23620.59
2003-04	661.21 (1.34)	42470.8 (86.26)	2187.36 (4.44)	3586.69 (7.28)	329.39 (0.67)	49235.4 (100)	51.08	14551.49	34683.91
2004-05	1764.31 (3.01)	46442.3 (79.25)	3048.38 (5.2)	6933.07 (11.83)	412.68 (0.7)	58600.78 (100)	52.72	20583.86	38016.92
2005-06	15308.8 (13.47)	643.76 (0.57)	0	97605.72 (85.87)	106.96 (0.09)	113665.2 (100)	22.25	90093.5	23571.7
2006-07	18181.8 (11.83)	79459.9 (51.72)	5084.32 (3.31)	50329.04 (32.76)	581.5 (0.38)	153636.5 (100)	24.41	118941.54	34694.95
2007-08	3512.67 (3.99)	55639.1 (63.34)	4899.23 (5.58)	23608.25 (26.87)	179.72 (0.2)	87838.94 (100)	33.57	25116.76	62722.18
2008-09	3297.39 (4.67)	34343 (48.68)	1710.01 (2.42)	31123.01 (44.12)	68.76 (0.097)	70542.18 (100)	29.28	25812.1	44730.08
2009-10	3120.11 (2.62)	78686 (65.97)	5130.03 (4.3)	32225.05 (27.02)	105.03 (0.08)	119266.3 (100)	45.53	25714.2	93552.06
2010-11	3222.29 (1.64)	149131 (75.79)	8974.38 (4.56)	35337.93 (17.96)	79.96 (0.04)	196745.1 (100)	54.96	29118.97	167626.17

Source: - Computed from Annual Reports of the Respective years.

Note: Figures in the bracket show the percentage to total.

It is evident from Table 1 that the size of current assets has increased from Rs. 32,898.18 lakhs in 2001-2002 to Rs. 1, 96,745.14 lakhs in 2010-2011, the growth being approximately 5.98 times. In the analysis the increase in current assets has been regular through out the period except in 2007-2008 and 2008-2009 it has decreased. The reason for decrease in current assets in 2007-2008, was due to decrease in Loan and Advances component of the selected company. The table also reveals that on an average 44.14 per cent of the total assets of the company are current assets. This indicates that during this period the major portion of the total investment of the BCML has been made on the working Capital. A component wise analysis of the working capital also done to trace the component responsible for the significant changes in different years. From the table it is evident that the two components namely inventory and loans and advances contributed and average of 64 percent and 27 percent respectively towards the gross working capital, whereas cash and bank, sundry debtors and other current assets contributed 5.4 and 0.35 percent respectively. The share of different components of current assets during the study period reflects fluctuation trends in BCML. Major portion of current liabilities includes salaries and wages creditors and cost of raw materials and other liabilities regarding employees etc. Component wise analysis explicitly depicted that the company having enough working capital through out the period under study. There is positive trend working capital and shot-term liquidity is considered good.

2. FINANCING OF WORKING CAPITAL

It is most dominant task to select an assortment of appropriate sources to finance the current assets. An enterprise has various sources to meet its financial requirement within the time. Generally the current assets of a business firm are associated by a combination of long-term and short-term sources of financing. It is evident from Table 2, an attempt has been made to elaborate the relative significance of long-term and short-term debt in financing of working capital.

TABLE – 2: FINANCING OF WORKING CAPITAL (Rs. In lakhs)

Particulars	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Gross Working Capital	32898.18	36474.62	49235.4	58600.78	113665.2	153636.49	87838.9	70542.18	119266.26	196745.1
Sources of Working Capital										
(A) Long Term	9889.19	12780.71	15281.88	24860.36	85860.36	99863.72	60527.3	47594.81	80468.94	94604.86
(B) Short Term	23008.99	23693.91	33953.52	33740.42	27804.84	53772.77	27311.6	22947.37	38797.32	263340.1
Total Long Term Funds	44318.14	56559.77	89370.98	98010.03	755762.5	1178296.8	232126	240891.63	288863.53	357945
Percentage of Long Term Fund- used for Working Capital	22.31	22.59	17.09	25.37	11.36	8.48	26.07	19.76	27.85	26.43

Source. Computed from Annual Reports.

From the table analysis, the percentage of long-term funds used for financing working capital has reflected fluctuating trend during the period of study. In the year 2002 percentage of Long-Term funds used 22.31 percent, and afterwards it increased to 27.85 percent maximum in 2009-2010. In 2002-2003 it is decreased to 22.59 percent to and finally, it is decreased to 8.48 percent in the year 2006-2007. This declining trend reflected that BCML utilized its long-term funds more effectively and efficiently by investing them in the fixed assets. It can be observed in the table also reflects the fact that the capacity of the BCML to make efficient management of its current assets.

3. WORKING CAPITAL TREND

In the working capital analysis the dimension of change over a span of time it is vital aspect in the financial management. **Man Mohan and Goyal** have suggested the importance of analysis of working capital trends, the practice and prevailing policy of the management with regard to working capital good enough or an improvement is to be made in managing the working capital funds. In the study original and trend values of working capital of BCML is presented in Table 3.

TABLE 3: ORIGINAL AND TREND VALUES OF WORKING CAPITAL (Rs. In lakhs)

Year	Original Working Capital	Trend Value	Chi-Square
2002	17987.03	345.78	900033.84
2003	23620.59	12295.73	10430.65
2004	34683.91	24245.68	4493.85
2005	38016.92	36195.63	91.64
2006	23571.7	48145.58	12542.7
2007	34694.95	60095.53	10736.06
2008	62722.18	72045.48	1206.51
2009	44730.08	83995.43	18355.37
2010	93552.06	95945.38	59.7
2011	167626.17	107895.33	33066.98
Total			991017.3

Note: $-(Y'/C = -11604.17 + (11949.95)(x))$

(Origin of x--2001-2002, x in units of years)

Source: Compiled from Annual Reports. (Statistical Computations have been done through SPSS.)

The number of degrees of freedom $v = n-1=10-1=9$

From the given values we find that 5 % value of Chi-square for 9 degrees of freedom=16.92

The Calculated value of chi-square viz, 991017.30 is much greater than the table value.

It is evident from the table that the working capital of BCML exhibited increasing trend during the study. The net working capital of BCML increased to Rs.1, 67,626.17 lakhs in 2010-2011 from Rs. 17,987.03 lakhs in 2001-2002. The linear least square trend values of working capital in BCML are also reflected in Table3. The yearly increase in working capital comes to Rs.11, 949.95 lakhs in 2001-2002. The difference in original working capital and trend values were negative in the year 2005-2006, 2007-2008, 2008-2009 and 2009-2010 while they were positive in the remaining years. The calculated value of Chi-square is 9, 91,017.30 while the table value of Chi-Square only 16.92 at 5 percent level of significance. Therefore, it can be observed that in BCML, the difference between the original and trend values of working capital are significant because the calculated value Chi-Square is much greater than the table value of Chi-Square.

4. IMPACT OF WORKING CAPITAL ON PROFITABILITY

In order to analyze the liquidity condition and its impact on profitability, it is important to judge the different working capital ratios as reflected in Table 4. It is evident from the table that current ratios of BCML have moved between 1.26 to 6.76 during the period of study. On an average, it comes at 3.14 for the entire period. Conventionally, a standard of 2:1 is considered satisfactory. Therefore the results indicated that the liquidity position of BCML, as measured satisfactory. This result indicates that the margin of safety available to short-term creditors is usually high i.e. for every rupee of current liability the cushion available is Rs.3.14. The Co-efficient of correlation between the profitability ratio and current ratio of BCML is (-0.365). This signifies that there is a lower degree of negative correlation between the two variables.

TABLE- 4: IMPACT OF WORKING CAPITAL ON PROFITABILITY

Year	C.R.	L.R.	WTR.	ITR	RTR	CTR	WC/TA	PBT	ACP
2001-02	2.21	0.05	3.05	1.9	42.57	62.15	0.41	0.13	8 days
2002-03	2.84	0.02	2.39	1.87	37.12	163.72	0.42	0.07	10 days
2003-04	3.38	0.04	2.13	1.74	33.75	111.64	0.39	0.09	11 days
2004-05	2.85	0.08	2.14	1.75	26.66	46.06	0.39	0.17	14 days
2005-06	1.26	0.17	8.05	294.89	0	12.4	0.06	0.23	0
2006-07	1.29	0.16	4.01	1.75	27.37	7.65	0.03	0.02	13 days
2007-08	3.49	0.14	2.33	2.63	29.87	41.66	0.24	0.05	12 days
2008-09	2.73	0.13	3.8	4.95	99.42	51.56	0.19	0.1	4 days
2009-10	4.63	0.12	2.3	2.74	41.98	69.02	0.37	0.08	9 days
2010-11	6.76	0.11	1.77	1.99	33.12	92.24	0.47	0.06	11 days
Coefficient of correlation	-0.365	0.055	0.618	0.737	-0.299	-0.271	-0.387		

CR-Current Ratio; LR- Liquid Ratio, WTR- Working Capital Turnover Ratio; ITR- Inventory Turnover Ratio; RTR- Receivable Turnover Ratio; CRT- Cash Turnover Ratio; WC/TA- Working Capital to Total Assets; PBT- Profit before to Total Assets. ACP-Average Collection Period.

Source: Compiled from Annual Reports. (Statistical Computations have been done through SPSS.)

The liquid ratio of the BCML has varied between 0.02 to 0.17 during the entire period of study. Normally 1:1 is considered to be the standard Liquid Ratio. On an average it has been maintained at Rs.0.102 for every rupee of quick liabilities. The co-efficient of correlation between the profitability ratio and liquid ratio of BCML is 0.055. This signifies that there is a lower degree of positive correlation between the two variables.

Working Capital Turnover ratio indicates the efficiency of the business firm in utilizing the working capital in the business. Working capital turnover ratio has been found to be positive through out the period under study. It varies between 1.77 times and 8.05 times. This ratio signifies that on an average a rupee of positive working capital to generate Rs. 3.197 worth of business firm which is obviously an alarming situation for the liquidity management purpose. The correlation between profitability ratio and working capital turnover ratio reflects a moderate positive correlation of 0.618.

The inventory turnover ratio of the BCML has varies between 1.74 to 294.89 during the entire period of study, it reflects a fluctuating trend. It indicates that, on an average a rupee invested in inventory generates Rs.31.6 worth of sales, which is satisfactory good. But inventory turnover ratio in 2003-2004 is not at all satisfactory in comparison to the other years. However, on overall inventory analysis, it pointed out that the management of inventory in BCML is considered good. The correlation between profitability ratio and inventory turnover ratio indicates a moderate positive correlation of 0.737.

The Receivables turnover ratio is highest (99.42 times) in 2008-2009 and lowest (27.37 times) in 2006-2007 and average is 37.19 times. It indicates that receivables management appears to be satisfactory good. The correlation between profitability ratio and receivable turnover ratio indicates a negative lower degree correlation of (-0.299).

The correlation co-efficient between profitability ratio and cash turnover ratio and working capital to total assets exhibits a negative correlation coefficient of 0.271 and 0.387 respectively. Therefore, the correlation analysis exhibited that LR, WTR, ITR and RTR have reflected positive correlation with profitability ratio and CR, CTR and WC/TA have reflected negative correlation with profitability ratio.

The average collection period is 9 days and it indicates that the company has to wait for 9 days for receiving for collection from debtors on account of credit sales. It indicates that the credit marketing policy of the company is very strict and rigid. It should be improved by making a good and effective credit marketing policy in the company.

5. MULTIPLE REGRESSION ANALYSIS

For performing regression analysis pooled data was used, and results of the model showing the impact of working capital ratio on profitability for the BCML are exhibited in Table 5.

TABLE 5

MULTIPLE REGRESSION ANALYSIS

Regression Statistics	
Multiple R	0.737
R Square	0.543
Adjusted R Square	0.486
Standard Error	0.04446

ANOVA					
	df	SS	MS	Overall F	Significant F
Regression	1	0.019	0.019	9.501*	0.015
Residual	8	0.016	0.002		
Total	9	0.035			

Variables	Beta Co-efficient Value	t-Value	Partial Correlation	Significant	Significant/Insignificant
Constant	0.084	5.646*	0	0.015	Significant
CR	-0.777	-0.276*	-0.104	0.791	Significant
LR	-0.364	-1.438*	-0.477	0.194	Significant
WTR	-0.384	-0.607*	-0.223	0.563	Significant
RTR	0.111	0.375*	0.14	0.719	Significant
CTR	0.03	0.108*	0.041	0.917	Significant
WC/TA	0.393	1.497*	0.492	0.178	Significant

*Significant at 5% Level.

Note: SS-Sum of Square

MS-Mean Square

Source: Compiled from Annual Reports. (Statistical Computations have been done through SPSS.)

The table reflects that the impact of current ratio, liquid ratio, working capital turnover ratio, cash turnover ratio and working capital to total assets ratio were statistically significant as seen from the values of regression coefficient. For a unit increase in liquid ratio profitability decreased by 0.364 unit which was statistically significant at 5 percent level. Similarly, one unit increase in working capital turnover ratio would decrease the profitability by 0.384 units which is also significant at 5 percent level. The co-efficient of regression between the profitability ratio and receivables turnover ratio is calculated as 0.111 which suggests that one unit increase in receivables turnover ratio would increase the profitability by 0.111 units and this co-efficient also statistically significant at 5 percent level. The table also indicates that one unit increase in working capital to total assets ratio would increase the profitability by 0.393 units.

The six independent variables contribute 54 percent of the variations in profitability of the BCML. Hence the overall analysis exhibited in the table is encouraging. The sign of all co-efficient are as expected and the co-efficient are also statistically significant.

RECOMMENDATIONS

The BCML study is strongly recommended to adopt the following measures immediately for its revival and overcoming working capital crises. Followings are the recommendations which I have observed are as follows.

1. Effort reducing working capital is a continuous exercise and it is an opportunity for improvement. All the managers should try to sort –out the problem arising due to this situation.
2. The company has idle cash in Bank it should be utilized in purchase of short-term marketable securities to boost the financial health of the company.
3. Inventory level should be fixed up scientifically and introduction of Just in time (JIT) is prescribed so that inventory carrying cost can be reduced to the minimum extent. No inventory should be allowed to accumulate as the inventory is the graveyard of any business. Company has glut of inventory which is blocking big portion of working capital hence efficient inventory management is required.
4. Lack of proper debt –management hence a proper credit policy required so company need to adopt an effective credit and collection policy.
5. To make SWOT analysis for determining appropriate revival business strategy for the company.
6. The company is finally advised to follow the principles to manage liquidity, solvency, profitability, survival and growth of the business.

CONCLUSION

Working Capital Management plays a crucial role in the success of a business firm. From my observation it is also clear that the overall financial health of company not only depends on the profitability of the concern but also it depends on the liquidity health of the company. The efficient management of working capital is important from the point of view of both liquidity and profitability. Working Capital Management should not be treated as an isolated management function but it is integral part of corporate management and impact of management policy and strategy effects working capital management of the company. In this research study normally indicates a moderate trend in the financial situation and the utilization of working capital. An attempt should also be made use funds more effectively by keeping more current assets causes of decline in profitability of the company. Hence, effort should be made proper working capital with effective and efficiently in the company.

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