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Contributions to books

- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

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WORKING CAPITAL MANAGEMENT: POLICIES AND PRACTICES AT SAREGAMA INDIA LIMITED

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ABSTRACT

This study seeks to study current policies and practices of working capital management at Saregama India Limited and tries to identify the strengths and weaknesses of the company; the opportunities it has and the threats it faces. It contains a detailed analysis of the various factors affecting the working capital requirements of the company and the impact they have on its profitability. The statistical tools for the purpose of this study are ratio and trend analysis.

An attempt has been made to identify the concern areas after an in-depth analysis of the company's operations and recommend solutions for the same. The company has certain concern areas like declining physical sales, return of goods sold, long gestation period of films and delayed payments by debtors. The company also faces a problem of unsold stock of goods which are non-moving. The ways in which such stock should be liquidated has also been discussed.

The study concludes by suggesting solutions to address the concern areas that have been identified. The company is recommended to focus on digital sales, incentivize cash sales, follow a forecasting model that captures the tastes and preferences of consumers and strictly implement its credit policy.

KEYWORDS

working capital, management, liquidity, cash

INTRODUCTION

Corporate finance basically deals with three decisions: *capital budgeting decisions, capital structure decisions and working capital management decisions.* Of these three pillars, capital budgeting deals with the subject of deciding what long-term investments to make. Capital structure helps to decide the mix between debt and equity and where to source each from. And the third pillar, working capital management, focuses on how an organization manages its day-to-day financial activities. Among these, working capital management is a very important component of corporate finance since it affects the liquidity and profitability of a company.

The corporate finance literature has traditionally focused on the study of long-term financial decisions, particularly investments, capital structure, dividends or company valuation decisions. However, short-term assets and liabilities are important components of total assets and needs to be carefully analyzed. Management of these short-term assets and liabilities warrants a careful investigation since the working capital management plays an important role for the firm's profitability and risk as well as its value (Smith, 1980). Efficient management of working capital is a fundamental part of the overall corporate strategy to create the shareholders' value. Firms try to keep an optimal level of working capital that maximizes their value (Afza and Nazir, 2007).

Working capital is the lifeblood of any business. It not only indicates a firm's efficiency, but also its short-term financial health. If it is properly managed and nurtured, the business prospers and grows, if not, the business heads towards sickness leading to all types of operational problems. It is essential for the smooth flow of day-to-day activities of the business. *Working capital management* is one of the most complex business processes to deal with due to its *multi-faceted nature*. The functional interdependencies of sales, operations and finance must be seamlessly integrated and flawlessly executed to unlock the hidden working capital. Superior working capital productivity helps organizations build streamlined processes, survive economic downturns and fund business growth.

The management of working capital assumes added importance especially when there is *liquidity crunch* in the economy and bank finance availability for working capital purposes becomes increasingly difficult. Managing cash flows under *exceptional time pressure* is the crux for success. But too much or too little working capital can impair the company's flexibility and performance. Hence, a *delicate balance* needs to be maintained in order to ensure the company is able to earn a decent return on its investments.

This study is significant due to the following reasons:

- It gives an analytical insight into the areas where working capital is tied up and how it can be liquidated.
- It critically evaluates the impact working capital management has on the company's profitability.

OBJECTIVES OF THE STUDY

In this paper an attempt has been made to study the working capital policies and practices at Saregama India Limited with special reference to the current scenario of economic recession, in which availability of working capital finance is a major challenge. The objectives of this study are five-fold. They are as follows:

a. To gain sound knowledge of how working capital is managed in an entertainment company like Saregama India Limited.
b. To analyze the current scenario at Saregama India Limited.
c. To analyze the working capital requirements of Saregama India Limited.
d. To investigate the concern areas.
e. To recommend solutions for the concern areas.

METHODOLOGY

For the preparation of this study, both primary as well as secondary sources of data have been used.

The primary data has been sourced from the company. The interview method has been adopted to gain first hand information from employees of Saregama India Limited. Visits to the company's factory in Dum Dum have been undertaken to gain an insight into the supply chain and inventory management practices of the company. Visits to the Regional Office in Chowringee have also been undertaken for understanding the sales and debtor management practices of the company. Interactions with the employees in the company's regional offices in other cities have also been undertaken to gain more information about their operations.

The secondary data used for the purpose of analysis has been sourced from several research papers, industry reports, newspaper articles, books and internet portals. Books by *M. Y. Khan and P.K. Jain, Brealey and Myers, Prasanna Chandra and R. P. Rustagi* have been referred by the author. Data from the *CMIE database* has also been used for the purpose of analysis. A comprehensive list of authors and research scholars that have been referred to is given at the end of the report.

Data has also been sourced from the financial statements of the company for the past five years for the purpose of analysis. The tool of ratio analysis has been used to monitor the overall trends in working capital management of the company and to identify areas that need close monitoring. Statistical tool of trend analysis has also been used to study the financial statements of the company. The data has been edited, classified and tabulated as per requirements of the project.

LIMITATIONS OF THE STUDY

Though an attempt has been made to make this project as comprehensive as possible, there still remain certain limitations which can be explored in future. They are as follows:

- A comprehensive evaluation of the practices of competitors of Saregama India Ltd. is beyond the scope of this report.
- Piracy, a major area of concern for Saregama India Ltd. and its impact on working capital management cannot be dealt with in great detail due to the absence of appropriate information.
- Due to constraint of historical information, publication – the business segment in which the company has ventured into recently – could not be analyzed.
- The short span of time is also a constraint as far as evaluation of the diverse operations of the company is concerned.

The study has been divided into various sections. The first section deals with the literature review. The second section talks about the latest developments in the industry. The third section analyzes the liquidity position. The fourth section talks about the concern areas and their solutions. The fifth section concludes.

LITERATURE REVIEW

Working capital is the lifeblood of any business. It not only indicates a firm's efficiency, but also its short-term financial health. If working capital is properly managed and nurtured, the business prospers and grows, if not, the business heads towards sickness leading to all types of operational problems. It is essential for the smooth flow of day-to-day activities of the business. The management of working capital assumes added importance especially when there is liquidity crunch in the economy and bank finance availability for working capital purposes becomes increasingly difficult. Managing cash flows under exceptional time pressure is the crux for success. But too much or too little working capital can impair the company's flexibility and performance. Hence, a delicate balance needs to be maintained in order to ensure the company is able to earn a decent return on its investments.

In a broader spectrum, from the perspective of Chief Financial Officer (CFO), working capital management is simple and a straightforward concept of ensuring the ability of the organization to fund the difference between the short term assets and short term liabilities (Harris, 2005). However, a "*Total*" approach should be followed which covers all the company's activities relating to vendor, customer and product (Hall, 2002).

To *sustain shareholder value*, a business needs to generate a return equivalent to at least its weighted cost of capital for every rupee tied up in *working capital*. This represents a considerable challenge for managers, more so in the current scenario of economic recession (Macdonald, 2002).

In practice, working capital management has become one of the most important issues in the organizations where many financial executives are struggling to identify the basic working capital drivers and the appropriate level of working capital (Lamberson 1995). Consequently, companies can minimize risk and improve the overall performance by understanding the role and drivers of working capital. A firm may adopt an aggressive working capital management policy with a low level of current assets as percentage of total assets or it may also used for the financing decisions of the firm in the form of high level of current liabilities as percentage of total liabilities. Excessive levels of current assets may have a negative effect on the firm's profitability whereas a low level of current assets may lead to lower level of liquidity and stock outs resulting in difficulties in maintaining smooth operations (Van Horne and Wachowicz, 2004).

A firm is required to maintain liquidity in its day-to-day operations to ensure smooth running of the operations and to meet its short-term obligations. But, this is not a simple and straightforward task, as it has to operate its business both efficiently and profitably. In the process, the asset-liability mismatch may occur and it may increase firm's profitability in the short-run but at a risk of its bankruptcy. Higher liquidity in a firm gives the comfort of meeting short-term liabilities but at the cost of the profitability and on the other hand, too little of it may increase the profitability but at a greater risk of not meeting the short-run obligations. Thus, a Finance manager is in a dilemma of achieving desired tradeoff between liquidity vs. profitability in order to maximize the value of a firm (Anand and Gupta, 2001).

Van Horne (1977) described working capital management as the administration of current assets in the name of cash, marketable securities, receivables and inventories; and according to Osisioma (1997), working capital management is the regulation, adjustment and control of the balance of current assets and current liabilities of a firm such that maturing obligations are met, and the fixed assets are properly serviced.

Shin and Soenen (1998) point out that a corporation's working capital is the result of the time lag between the expenditure for the purchase of raw materials and the collection from the sale of finished goods. As such, it involves many different aspects of corporate operational management: management of receivables, management of inventories, management and use of trade credit, etc.

However, for there to be good working capital management, there must exist two elements: *Necessary Components; and Desirable Quantities.* The necessary components of an organization's working capital, basically, depend on the type of business and industry. Cash, debtors, receivables, inventories, marketable securities, and redeemable futures can be recognized as the common components of organization's working capital. However, the question is to recognize the factors that determine the adequacy of working capital based on growth, size, operating cash flow, etc. The inability to understand the determining factors and measurement of adequate amounts of working capital will lead an organization to bankruptcy (Osisioma 1997).

Continuing, Osisioma (1997) opined that good working capital management must ensure an acceptable relationship between the different components of a firm's working capital so as to make for an efficient mix, which will guarantee capital adequacy. In the same vein working capital management should seek to make available to the management the desirable quantities of each component of the working capital (Enyi, 2005).

In the majority of businesses, working capital is viewed as a balance sheet item and its management a part of the finance and treasury function – yet all the activities which give rise to working capital takes place outside this function. Despite the 'matrix' character of most organizations nowadays, few managers have identified and defined the inter-relationships between those performance criteria – both financial and non-financial – that are necessary to manage working capital efficiently (Macdonald, 2002).

The main objective of working capital management is to maintain an optimal balance between each of the working capital components. Business success heavily depends on the ability of financial executives to effectively manage receivables, inventory, and payables (Filbeck and Krueger, 2005). Firms can reduce their financing costs and/or increase the funds available for expansion projects by minimizing the amount of investment tied up in current assets. Most of the financial managers' time and effort are allocated in bringing non-optimal levels of current assets and liabilities back toward optimal levels (Lamberson, 1995). An optimal level of working capital would be the one in which a balance is achieved between risk and efficiency. It requires continuous monitoring to maintain proper level in various components of working capital i.e. cash receivables, inventory and payables etc.

Efficient working capital management involves planning and controlling current assets and current liabilities in a manner that eliminates the risk of inability to meet due short term obligations on one hand and avoids excessive investment in these assets on the other hand (Eljelly, 2004).

Historically, business managers expected new best-of-breed enterprise systems to enable more effective management of working capital, usually through standardization and simplification of supply chain processes. But, as it has turned out, their expectations have not been met, partly because these systems are not pre-configured with working capital matrices and partly because focusing on the supply chain itself only addresses part of the problem.

In general, current assets are considered as one of the important component of total assets of a firm. A firm may be able to reduce the investment in fixed assets by renting or leasing plant and machinery, whereas, the same policy cannot be followed for the components of working capital. The high level of current assets may reduce the risk of liquidity associated with the opportunity cost of funds that may have been invested in long-term assets (Afza and Nazir, 2009).

To address the working capital management issue, we need to look across the *entire business value chain* to identify the key activities that impact working capital; to help process owners understand their role in managing working capital; and to identify and measure key performance indicators. It is the role of the finance function to co-ordinate this activity and monitor the outcomes (Macdonald, 2002).

Corporations are looking for new ways to stimulate growth, improve financial performance, and reduce risk in today's challenging economic climate. Funds tied up in working capital can be seen as hidden reserves that can be used to fund growth strategies, such as capital expansion. Cash flows locked in stock and receivables can be freed up by understanding the determinants of working capital. Many organizations that have earned profits over the years have shown the efficient management of working capital (WCM). The successful management of working capital is essential for short-run corporate solvency or the survival of any organization. Especially, efficient WCM will lead a firm to react quickly and appropriately to unanticipated changes in market variables, such as interest rates and raw material prices, and gain competitive advantages over its rivals. Too often, however, this is an area that many organizations have ignored. The way of managing working capital efficiently varies from firm to firm since it depends on industry, the nature of the business, business policy, strategy, etc. Thus, it is very important for an organization to understand the way to manage working capital efficiently (Appuhami, 2008).

As every business school graduate knows, cash recaptured from working capital is cash that can be used more effectively elsewhere – in debt reduction, in research and development, in growth through acquisitions, in buying back stock or in raising corporate dividend. Unfortunately, opportunities to reduce working capital are routinely overlooked by managers attending to seemingly more pressing matters – a merger here, an acquisition there or the launch of a new product. What they too often fail to appreciate is that working capital management – the diligent prosecution of all matters related to expenditure, supply chain and revenue management – is one of the fastest and most cost-effective way for businesses of any size to enhance shareholder value.

Working capital initiatives are an especially attractive source of cash when, like now, a slumping economy makes it more difficult to access funds through traditional channels such as commercial banks, venture capital or equity markets. Companies have virtually no control over such factors. However, even when money is readily available, working capital initiatives are an appealing alternative. Unlike a debt issue, a program to reduce working capital improves key balance sheet ratios. Unlike an equity issue, there is no dilution of control. And the pay-offs generally are spectacular.

The benefits of improved working capital management are not limited to the balance sheet or the income statement. Because drivers of working capital are operational in nature, projects to reduce working capital levels often generate operational improvements that boost customer satisfaction. Eliminate the problems that cause your customers to delay paying their bills, for example, and you don't just shorten your collection cycle, you make your customers happier too – and more inclined to buy the goods and services your company sells (Payne, 2002).

INDUSTRY OVERVIEW

Consistent commitment to economic reform over the last decade has spurred the steady growth of the Indian economy. The emphasis on creating an enabling environment for investment has been key factor supporting this growth. This growth has had a positive effect on the Indian entertainment industry.

The Indian entertainment industry is on the threshold of emerging as a large market globally. Future growth of the industry is expected to be led by rising spends on entertainment by a growing Indian middle class, increased corporate investments, regulatory initiatives and the industry's dynamic initiatives to make strategic structural corrections to grow. In addition to the Indian middle class' enhanced spends projected towards entertainment, the rising global interest in Indian content is expected to fuel growth in this industry.

Given the average India's cultural affinity for entertainment, the Indian entertainment industry's growing contribution to the economy cannot be understated. The entertainment industry in India has the potential to be the next 'sunrise' industry and is undergoing significant changes. Increasingly, the Indian entertainment industry is being influenced by international trends and developments. The industry is steadily moving towards corporatization and globalised markets.

The spend on entertainment in India is significantly lower than most advanced countries, yet the growing middle class exhibits a greater propensity to spend on entertainment, when we consider the entertainment spend as a percentage of per capita spend. As the Indian economy grows, the rest of the population is moving towards a higher standard of living. It is this growing consuming class with the propensity to spend that will drive the growth of the Indian entertainment industry.

The drivers of growth in the future will be:

- Consumerism
- Content
- Regulation
- Technology
- Pricing

FACTORS INFLUENCING WORKING CAPITAL REQUIREMENTS

The working capital needs of a firm are influenced by numerous factors. The important are:

1. **Nature of business: The working capital requirement of a firm is closely related to the nature of its business. Some enterprises need to maintain sufficient level of inventories, debtors and cash in** order to function smoothly and thus have to invest large amounts in working capital. On the other hand, some which operate entirely on cash basis have relatively less working capital investment. It is very important to properly analyze and understand the nature of business when we want to determine its working capital requirements. (Chandra, 2007)
2. Business cycle: The cyclicality of business operations also has an effect on the working capital position and requirements. When the economy is in upswing and boom conditions prevail, an enterprise is likely to have increased requirements of working capital to support the enhanced level of sales and increased demand. However, during a downswing when recessionary tendencies prevail and economic activities decline, a firm would like to reduce its investment in working capital as demand for goods and services declines. (Khan and Jain, 2007)
3. Seasonality of operations: Firms which have marked seasonality in their operations have highly fluctuating working capital requirements. On the other hand, firms which have fairly even sales all throughout the year, have stable working capital requirements. For example, an air-conditioner manufacturer would have high working capital requirements in summer months when compared to winter months. (Chandra, 2007)
4. Production Policy: The quantum of working capital required is also influenced by the production policy of the enterprise. An enterprise which sells a seasonal product may have two choices – to produce only when there is demand or follow a steady production policy throughout. The enterprise would have to evaluate which policy suits its overall organizational objectives best as in the first case there is a risk of lost sales and in the second there is an increased investment in working capital.
5. Production cycle: The term production cycle refers to the time involved in the manufacture of goods. It covers the time-span between the procurement of raw materials and the completion of the manufacturing process leading to the production of finished goods. Funds are generally tied up in the process of manufacture, necessitating enhanced requirement of working capital. The longer the production cycle, greater is the requirement of working capital.
6. Credit policy: The credit policy relating to purchases and sales also affects the working capital. The credit terms extended by the creditors help a firm to finance its investment in current assets to an extent. If the terms are liberal, the company can benefit from it as the need for working capital is less. The credit terms granted to the customers also has a bearing on the magnitude of working capital by determining the level of book debts. A liberal policy would mean higher book debts and hence greater investment in working capital. Hence, a suitable credit policy must be pursued in order to reduce the funds required as working capital by the company. (Khan and Jain, 2007)
7. Market Conditions: In today's market, "*Customer is King*". The degree of competition prevailing in the market place has an important bearing on working capital needs. When competition is keen, a larger inventory of finished goods is required to promptly serve the customers who may not be inclined to wait as other manufacturers are ready to meet their needs. Further, liberal credit terms may have to be offered in order to attract customers in a competitive market. Thus the need for working capital increases.
8. Conditions of Supply: The inventory of raw materials, spares and stores depends on the conditions of supply. If the supply is prompt and adequate, the firm can manage with small inventory. However, if the supply is scant and unpredictable, then the firm would have to acquire stocks when they are available in order to ensure continuity of production. This would mean carrying larger inventory on an average. (Chandra, 2007)

9. Growth and Expansion: As a company grows, it is logical to expect that a larger amount of working capital would be required. It is, of course, difficult to determine precisely the relationship between the growth and the volume of business of the company and the increased working capital required. The critical fact, however, is that the need for increased working capital funds does not follow the growth in business activities but precedes it.
10. Dividend Policy: Dividend is an appropriation of profit that has an impact on working capital of the enterprise. The payment of dividend consumes cash resources and thereby affects working capital to that extent. In planning working capital requirements, therefore, a basic question to be decided is whether profits would be retained or be paid out to the shareholders.
11. Depreciation policy: Depreciation is a charge against an asset that relates to the loss in the value of the asset due to use, wear and tear and efflux of time. Depreciation charges do not involve any cash outflows. The effect of depreciation policy on working capital is, therefore, indirect. Depreciation affects tax liability and retention of profits. Selection of method of depreciation also has important financial implications. Since, there are no cash outflows; depreciation makes available cash resources to the firm and hence is relevant for working capital planning. (Khan and Jain, 2007)

RECEIVABLES MANAGEMENT

The receivables represent an important part of the current assts of the company. It is of utmost importance for the company to ensure that the collection from the debtors is swift and timely. If that is not the case then precious working capital will be tied up in debtors and the company will face difficulties in managing in working capital.

The close monitoring of debtors is quite significant as we know *Cash is King*. In the event of them failing to pay on time, the company has to take a double hit. In the first place, if the debtors do not pay on time, the forecast the company makes about cash flows goes awry and its liquidity suffers. Hence it has to face difficulty in meeting its other obligations. There is also an interest cost involved which has a negative impact on the company's earnings. Secondly, as the debtors go on delaying the payments, the burden of provisioning also increases. This ultimately hampers the profitability of the company.

When we talk about receivables management, we need to look into the 5 C's which help us formulate our credit policy. They are as follows:

Character- The willingness of the customer to pay.
Capacity- The ability of the customer to pay.
Conditions- The economic conditions prevailing at the time.
Capital- The financial reserves of a customer.
Collateral- The security offered by the customer.

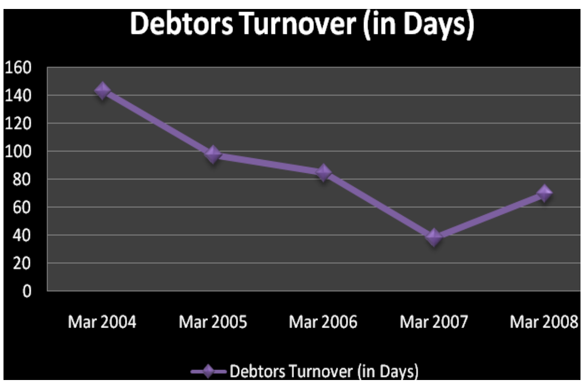
Saregama India Ltd. has also focused on managing receivables properly. They have clearly spelt out the terms of trade for various classes of debtors. They direct their efforts on following the same. The major share of debtors comes from the company's music business. Primarily, it relates to the debtors who arise in relation to the credit extended by the company to the wholesalers, retailers and large-format outlets. The company also has some debtors in the television business who arise mainly on account of the free commercial time sold by the company.

Terms of Trade:

The company cannot reach out to its customers directly. Hence, it sells its products to wholesalers, retailers and large format outlets so that they can ultimately sell it to the final customer. The company extends a credit period to these parties based on their credit history. The terms are as follows:

- Wholesalers: The Company extends a credit period of 30 days to wholesalers like Suranjali, Shibham Enterprise, etc. They are expected to clear their dues within 30 days of the invoice date.
- Retailers: Retailers like Melody, M. Biswas and Symphony are also extended a credit period of 30 days by the company.
- Large format outlets: Players like Music World, Planet M, etc. are extended a credit period of 45 days by the company.

The music industry is a classic case of a buyer's market. The tastes and preferences of ultimate consumers go a long way in determining whether a product will sell or not. In such a scenario, the link between the company and the ultimate consumers i.e. the wholesalers, retailers and large format outlets, have greater bargaining power. The company always runs a risk that the products it has sold may come back as returns if it lies unsold with the middlemen.



On keen analysis of the company's debtors, it comes to light that the company has done reasonably well as far as improving debtors turnover is concerned. Over a five year period from 2003 to 2008, the company has managed to reduce its debtors' turnover from 143 days to a considerably low figure of 69 days on an average as can been seen in the graph above.

This means that, earlier the debtors made payments in 143 days on an average but now it has come down to 69 days. But, a *disconcerting fact* is that as on March, 2007 the debtors' turnover stood at 38 days and it spiked to 69 days as on March, 2008. This can be attributed to the fact that the economic conditions prevailing across the globe has led to a tightening of the credit market and debtors are trying to delay payments

as long as possible. Moreover, until the stock is sold the debtors do not make payments to the company. This is a common phenomenon across the music industry.
Hence, they also have clear cut provisioning norms as far as doubtful and bad debts are concerned. They are as follows:

Debtors Provisioning Norms

Days Sales Outstanding	**Percentage of provision**
Due over 180 days	**10%**
Due over 270 days	**33%**
Due over 365 days	**100%**

Every month, all the regions send the party-wise debtors details to the corporate office in Kolkata. The finance department in the corporate office then allocates the requisite amount of money as provisions for bad and doubtful debts. It is noteworthy that *provisioning is done only at the corporate level*. This is a good practice because *centralization of provisioning* helps the company to free up precious working capital that may have been otherwise tied up in the guise of provisions at regional level.

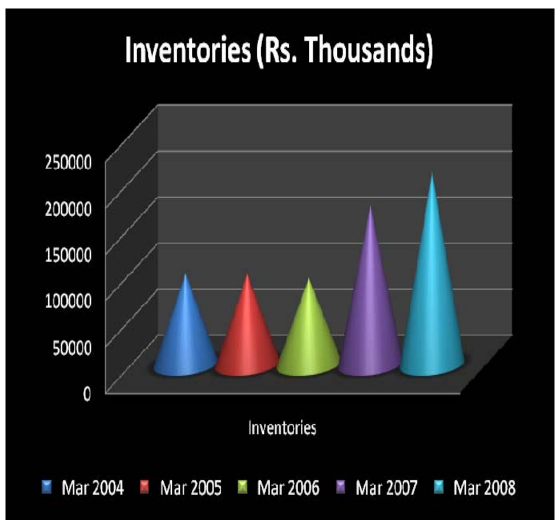
INVENTORY MANAGEMENT

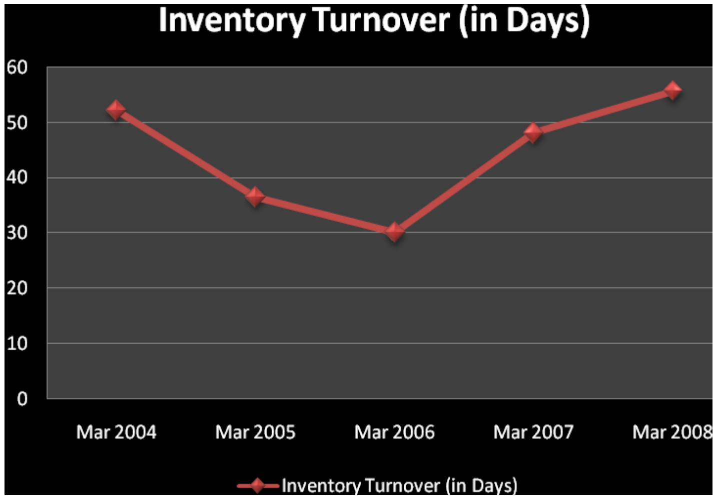
Inventories form a major component of current assets in which working capital funds are invested. The objectives of inventory management consist of two counterbalancing parts:

i. To minimize investment in inventory
ii. To meet the demand of products by efficiently organizing the production and sales operations.

The finance manager has the big responsibility of determining the adequate investment in inventory which will maximize the shareholder's wealth.

At Saregama, the major components of inventories are physical goods of the music vertical, unreleased films of the films division and un-telecasted serials and free commercial time of the television division. As we can see from the graph given below, the investment in inventories has increased substantially in the past two years. Earlier, it was about 12-13% of the current assets but for the past two years it has seen a sharp increase to 26-27% of the current assets.





As is evident from the graph above, the company had managed to improve its inventory turnover during the period 2004-2006. The inventory turnover in days had come down from 52 days to 30 days on an average. This meant that the company was able sell its inventory faster which was a good sign for the company. However, it was 48 days in 2007 and it went up further to 56 days in 2008. In the recent years, physical sales have dropped sharply and the demand estimated by the salespeople has not actualized. It has led to a pile up of unsold stock. This is not an encouraging sign as it means that precious working capital is tied in inventories for a longer period of time.

SALES PLAN AND PRODUCTION PLANNING

The planning horizon for music cassettes is 1 month and for *CDs, MP3s, VCDs and DVDs,* it is 3 months. At present, Saregama does not follow any *forecasting model* to forecast the demand of its products. The sales force estimates the demand based on the market conditions and historical sales. The regional offices send *monthly requirements for music cassettes* and *quarterly requirements for CDs, MP3s, VCDs and DVDs* to the production planning team located at Dum Dum. These requirements are sent according to coupling numbers. Coupling numbers are in-house identification codes which allow the company to assess the stock position of any product. It also acts like an indicator for pricing of the product. The coupling codes are as follows:

Coupling Code	Item
8	Music Cassettes
1	CDs
M	MP3s
V	VCDs
D	DVDs

The complete identification code has the following format:

Coupling Code – Title – Format – Genre

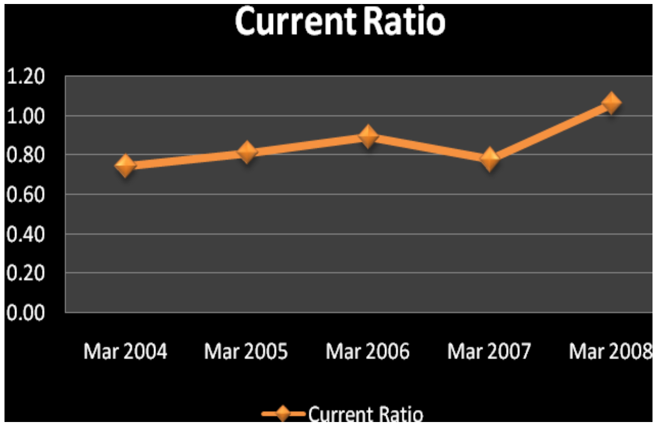
After receiving the sales plan from the regional sales offices, the production planning team at Dum Dum collates and consolidates the entire information. Then it runs an *excess stock allocation program*. Herein, the team identifies whether the product required by one regional office is lying unsold at another. If it is able to find excess stock at any location, it sends those products to the location which requires it. If there is a product for which demand still remains unsatisfied after the excess stock allocation program has been run, the company goes in for production. However, there is an economic order quantity below which production cannot be carried on. For music cassettes, the economic order quantity is 35 units and for CDs, MP3s, VCDs and DVDs it is 300 units. It must be noted here that *production is strictly based on indent*.

ANALYSIS OF LIQUIDITY

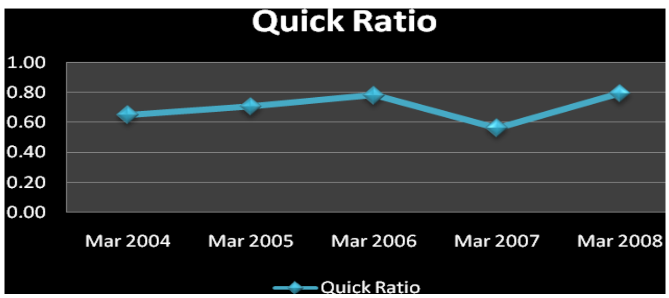
An important task of the finance manager in the area of working capital management is managing adequate liquidity in the organization. The firm needs to have adequate funds at all times in order to meet its short-term obligations and avoid the risk of bankruptcy. Managing liquidity is a challenge because a lot of external factors have an impact on it and they are beyond the control of the finance manager. I am analyzing the liquidity of Saregama India Limited by using the following ratios:

- Current Ratio
- Quick Ratio
- Cash to Current Assets Ratio

CURRENT RATIO: Current ratio is the ratio between current assets to current liabilities. Over the past five years, the current ratio of the company has shown an increasing trend barring the year 2007. But, a fact to take note of is that the company's current ratio has always been below the accepted standard of 2:1. It may be said that the company was following an aggressive working capital policy. But, for four of the past five years, it has been even below 1:1. This was a dangerous situation. The company faced a risk of inability to meet short term obligations in such a scenario. However, it is heartening to see the company tided over the difficult times and is on the path of progress now. The current ratio currently stands at a little over 1:1.

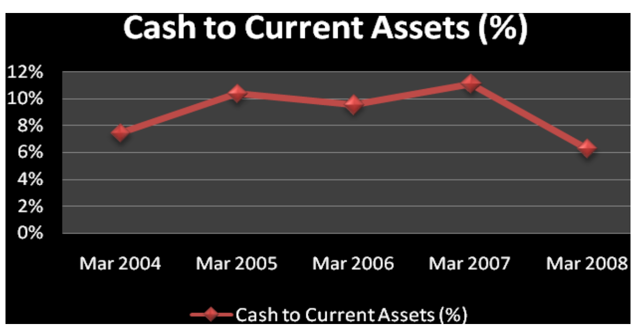


QUICK RATIO: The quick ratio of the company over the five-year period under study has been marginally below the accepted standard of 1:1. It has shown an improvement over the years. Though there was a sudden dip in the year 2007, it had stabilized again in 2008. The trend reveals that over the years, the company has improved its ability to meet its short-term obligations by enhancing its liquidity. As can be seen in the graph below, the quick ratio for Saregama has been improving over the years with the exception of 2007. This is a healthy sign for the company.



CASH TO CURRENT ASSETS: Cash component of the current assets has a lot of significance because we know that in business *Cash is King*. Cash is the most liquid form of the current assets. Ready availability of cash augurs well for the short-term financial health of the company. But, too much idle cash also is a risky proposition as the company would not get any returns on it. Over the five-year period under study, the cash component of the current assets had seen a stable increase but in the year 2008 it saw a sudden sharp drop. This drop has coincided with the high interest rate environment domestically.

As can be seen in the graph that below, cash represented about 10% of current assets on an average during the period 2004-2007. However, in 2008, it fell sharply to about 6% of the current assets. This should be taken as a warning sign. Hence, the cash position of the company should be closely monitored as it plays a crucial role in meeting the short-term obligations of the company.

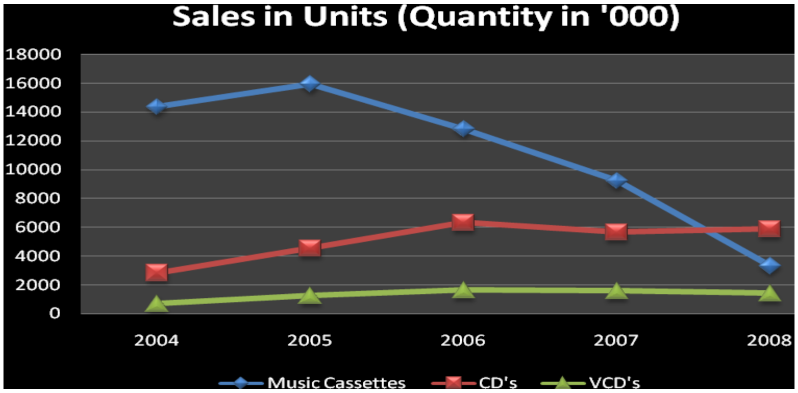


CONCERN AREAS

On keen analysis of the operations of the company, few concern areas have come into focus. They are as follows:

DECLINE IN PHYSICAL SALES

It's a fact of life the world over, that even though more and more music is being heard by consumers, physical sales have been declining rapidly over the years. Today, music is being consumed over I-pods, internet and radio. Music cassettes like the older LP records are losing their relevance and even CDs are yielding to cheaper MP3 disks and USB memory sticks. As we can see from the graph below, music cassettes sales have fallen drastically over the years and other formats like CDs and VCDs have more or less stagnated. In addition to this, piracy remains a major menace for the company and it adversely impacts the top-line and bottom-line of the company.



NO FORECASTING MODEL

At present the company does not follow any forecasting model to estimate the demand for its products. The sales plan is based on *off-the-hand estimates* made by the salespeople. This leads to a build-up of inventory which eventually remains unsold and ends up blocking a lot of working capital. Rough estimates by the company show that out of 800000 units produced, a pretty high volume of 300000 units remain unsold every month on an average. This is a serious concern for the company as liquidating such inventory becomes very difficult.

DELAY IN PAYMENTS

The large format outlets like Music World, Planet M, etc. are extended a credit period of 45 days by the company. They are expected to clear their dues with 45 days of the invoice date. However, on analysis of the debtors' history, it was observed that the large format retailers have a poor payment history. Credit extended to them is not realized within the due date. This creates a problem for the company as its cashflow forecasts go haywire. Moreover, it has a ripple effect on other activities of the company. As we can see from the table given below, a huge amount of money is still lying unpaid by the large format outlets. If this cash can be promptly collected from these players, the company will be hugely benefitted.

Debtors (In Rs. '000)	0 to 30 Days	31 to 60 Days	61 to 90 Days	91 to 180 Days	181 to 365 Days	> 365 Days
Music World	224	254	446	1093	896	14
Planet M Retail Ltd.	115	190	169	386	250	66

RETURNS FROM WHOLESALERS

The company has been facing a problem of returns as far as the wholesalers are concerned. These returns are a major concern for the company as a lot of useful working capital gets tied-up in the process. Liquidating such stock becomes a difficult task. This build-up of non-moving stock has an adverse impact on the profitability of the company and such stock, which gets too old, is also not considered by the banks when they evaluate the company's request for working capital finance.

BUILD-UP OF UNSOLD INVENTORY

The company is saddled with a huge volume of unsold inventory in the music business. Liquidating this inventory is a challenging task for the company as there is no demand for these products. It also blocks a lot of working capital which may be used alternatively to fund the growth of the company. With formats like music cassettes dying and audio CDs seeing a decline in appeal, the company also faces a risk of further increase in non-moving stock.

LONG GESTATION PERIOD OF FILMS

Film production, in general, has a long gestation period. A lot of working capital is tied in such projects and it may run into months at a stretch. The funds which are blocked earn no returns till the film is released. Hence, timely execution and completion of the projects become extremely important because a failure to do so would have a negative impact on the company.

RECOMMENDATIONS

In order to overcome the challenges faced, the company is advised to look into the following points:

- Give impetus to digital sales: It is quite evident from the recent trends that physical sales have been dropping over the years. Digital space is the battleground of the future. The way music is being consumed has changed. People now prefer listening to music on the I-pods, MP3 disks and USB memory sticks. In such a scenario, physical formats may die a natural death. In line with this development, the company has also undertaken a massive exercise to digitize its entire collection of songs. This would also help the company reach out to the young generation and thus provide a new revenue stream to it. Hence, the ability to compete in this space will be *critical to the success* of Saregama.
- Incentivize cash sales: It is an industry practice that music companies make sales to wholesalers, retailers and large-format outlets on an approval basis. These middlemen make payments to the companies only when the product gets sold. If products remain unsold, they

return it to the companies. Hence, Saregama always runs a risk that it might be saddled with stocks lying unsold at the end of those players. So, it will be a better option for the company to sell its products on a cash basis and price them accordingly to attract the players.

- Agreements with PSU's and other companies: It is very important for the company to liquidate the stock lying unsold with it as it consumes a lot if working capital and the company gets no returns from it. Hence, the company is advised to explore the options of entering into agreements with public sector behemoths like Indian Railways, State Bank of India, etc. and other private sector companies whereby it can sell such stock at a mutually agreed price to them. The other companies can use this stock in promotional schemes and bundle them with their core offerings. If such a deal can be struck, it will be a win-win situation for both the parties.
- Follow a forecasting model for catalogue products: The problems faced by the company due to the lack of a forecasting model have been discussed earlier. Hence, the company would be well advised to use a forecasting model that captures the recent trends in sales as well as the tastes and preferences of consumers based on current market scenario. This will help the company in optimizing its investment in inventories. Working capital which may have been otherwise stuck in inventories will be freed up and can be utilized alternatively.
- Manufacturing based on confirmed sales order for new products: For new products, the company should start manufacturing based on confirmed sales order instead of going in for production based on the projected sales. It will help the company optimize its investment in inventories and thereby give it headroom to utilize its working capital more efficiently.
- Discontinue the production of music cassettes: Given the fact that physical sales are on the decline and may die a natural death soon, the company should critically evaluate the value added by the production of music cassettes. Music cassettes sales have fallen dramatically in the past few years and it is anticipated that music cassettes, as a format, will have to be phased out very soon. The company has a huge cassette production facility in Dum Dum. The company should stop cassette production there and use the land bank to generate revenue from alternative sources.
- Strict implementation credit policy: Though the Company has a credit policy in place, it is evident from keen analysis of receivables that parties make delay in payments. It is important for the company to ensure that its credit policy is strictly followed and defaulters, if any, are dealt with according to the terms of the contract. The company should charge interest for late payments made by debtors. It should also try to persuade its debtors to make timely payments as it will considerably reduce its working capital requirements.
- Regular debtors balance confirmation to avoid disputes: There are instances when debtors delay payments citing differences in balances as maintained by them and those maintained by the company. The Company should confirm its debtors balance on a regular basis so that there are no disputes later which hold up cash. This would ensure prompt payment by the debtors and help the company manage its receivables more efficiently. It will be in a better position to forecast its cash inflows and thereby ensure efficient utilization of working capital.
- Regular reconciliation of creditor accounts to avoid future disputes: The Company should also focus on precise reconciliation of amounts due to creditors so that it can avoid disputes in future. This will allow the company to forecast its cash outflows accurately and thereby manage its working capital effectively. It will also help the company to enhance its relationships with the creditors.

CONCLUSION

Working capital is the lifeblood of any organization. Without proper working capital management no organization can function properly. A firm is required to maintain liquidity in its day-to-day operations to ensure smooth running of the operations and to meet its short-term obligations. But, this is not a simple and straightforward task, as it has to operate its business both efficiently and profitably.

Working capital management is highly important in firms as it is used to generate further returns for the stakeholders; however, it has attracted less attention of researchers and practitioners. When working capital is managed improperly, allocating more than enough of it will render management non-efficient and reduce the benefits of short term investments. On the other hand, if working capital is too low, the company may miss a lot of profitable investment opportunities or suffer short term liquidity crisis, leading to degradation of company credit, as it cannot respond effectively to temporary capital requirements. There may various external and internal factors that may induce the firms to strike a balance between meeting unforeseen capital requirements and avoiding non-efficient management of capital. Efficient 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 which are due, on one hand and avoids excessive investment in these assets on the other hand.

My project was aimed at understanding the policies and practices of working capital management at Saregama India Limited, identifying the concern areas and recommending solutions for the same. I have tried to be quite comprehensive and cover all the critical areas.

On keen analysis of the operations of Saregama India Limited certain issues have come up. It has some concern areas which need close monitoring. These include *declining physical sales, delays in payments by debtors, build-up of unsold inventories and long gestation period of films.*

Some solutions have been recommended for the concerns mentioned above. They include *focusing on digital sales, incentivizing cash sales, discontinuing production of music cassettes and strict implementation of credit policy.* The company has also been recommended to *follow a forecasting model* which captures tastes and preferences of the consumers so that it can avoid excess investment in inventories. The company can draw significant benefits if appropriate actions are taken based on the recommendations made.

The liquidity analysis of the company revealed that the past few years have been challenging but the company has managed to tide over the difficult phase and is now poised to move on the path of progress. Overall, the company is doing a commendable job of managing its working capital given the challenges it faces. At the end, it can be said that *working capital management does impact the financial health and profitability of the company*.

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WEB RESOURCES

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i) http://www.investopedia.com/terms/a/acidtest.asp
j) http://www.investopedia.com/terms/l/liquidityratios.asp
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