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LIQUIDITY MANAGEMENT IN MAA FRUITS PVT. LTD.

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ABSTRACT

The ultimate objective of any firm is to maximize the profit but increasing the profit at the cost of liquidity can bring serious problems too. A company having a proper set of liquidity management policies and procedure will improve profits, reduce the risk of corporate failure and significantly improve its chances of survival. Effective liquidity management will enable organization to derive maximum benefits at minimum cost. This study examines how liquidity is managed at MAA Fruits Pvt Limited, for which required ratios that indicate the liquidity position were calculated. Statistical techniques like standard deviation, coefficient of variation, Spearman's correlation coefficient,'t' test and Motaal's test have been employed in order to examine the liquidity position and test the relationship between liquidity and profitability. The study result show that the company enjoyed sound liquidity during the study period 2002-2006 but relationship between liquidity and profitability are statistically not significant.

KEY WORDS

liquidity, profitability, measurement, current assets, current liabilities.

INTRODUCTION

The importance of working capital management is reflected in the fact that financial managers spend a great deal of time in managing current assets and current liabilities like, arranging short term financing, negotiating favorable credit term, controlling the movement of cash, administering of account receivable and monitoring investments in inventories etc. Decisions concerning the areas play a vital role in maximizing overall value of the firm. This critical role can be enunciated by examining the flow of resources through the firm.

The ultimate objective of any firm is to maximize the profit. But, preserving the liquidity of the firm is an important objective too. The problem is that increasing profit at the cost of liquidity can bring serious problems to the firm. Finance managers play a lot a attention to the measurement and management of corporate liquidity.

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 (Elley,2004). Many surveys have indicated the managers spend considerable time on day to day problems that involve working capital decisions. One reason for this that current assets are short-lived investments that are continually being converted into other asset types(Rao 1989).

Liquidity in general refers to the financial strength of an organization. The term financial relates to two major sources of finance. These sources are categorized as internal sources and external sources of an organization. 'Strength' reveals the ability to meet obligations when they become due. Liquidity management in general has three dimensions.

- Dimension I is concerned with the formulation of policies with regard to risk, liquidity and return, keeping in view the goals and responsibilities of the firm.
- Dimension II is concerned with the decisions about the level and the composition of current assets.
- Dimension III is concerned with the decisions about the level and the composition of current liabilities.

Liquidity is the stage where assets may be converted into cash without losses. There is a need to balance between earning adequate returns, and cover the financial and business risk. IT also enables a company to make a rapid shift in its direction, in accordance

Liquidity in general refers to the financial strength of an organization. The term financial relates to two major sources of finance. These sources are categorized as internal sources and external sources of an organization. 'Strength' reveals the ability to meet obligations with the market demand. In order to measure the liquidity position of **MAA FRUITS INDIA Pvt. Ltd.,** during the period 2002 - 03 to 2005 – 06 certain important ratios have been computed.

NEED FOR THE STUDY

Liquidity management has become a basic and broad aspect of judging the performance of a corporate entity. It is, therefore, essential to maintain an adequate degree of liquidity for smooth running of the business operation. The liquidity should be neither excessive nor inadequate.

Excessive liquidity indicates accumulation of ideal funds which do not earn any profit for the business and inadequate liquidity not only adversely affects the credit worthiness of the firm but also interrupts the production process and hampers its earning capacity to a great extent.

REVIEW OF LITERATURE

The term 'Liquidity' refers to the ability of a firm to meet its obligations in the short run usually one year. The Liquidity resources of a firm may be kept in various forms: cash in hand and cash at bank in current assets, reserve drawing power under a cash credit or overdraft arrangement and short term deposits. Cash balances in current account provide the highest degree of liquidity.

According Hrishikes Bhattacharya, the term liquidity may be defined as "a firm can maintain liquidity if it holds assets that could be shifted that could be shifted or sold quickly with minimum transaction cost and loss in value. The test of liquidity is the ability of the firm to meet its cash obligations when they are due and to exploit sudden opportunities in the market.

According to Solomon, E and Springle J. Whenever one speaks of a firm's liquidity, he tries to measure firm's ability to meet expected and unexpected cash requirements, expand its assets, reduce its liabilities or cover any operating losses.

Teresa A John's paper on accounting measures of corporate liquidity, leverage and costs of financial distress examines the relationship of the costs financial distress to the level of corporate liability maintained and leverage. Overall study results show that there is evidence of consistency with the hypnotized positive relationship between corporate liquidity and financial distress costs, and the negative relationship between corporate leverage and financial distress costs.

Abuzar M.A.Eljelly (2004) study examines the relationship between profitability and liquidity, as measured by current ratio and cash gap (cash conversion cycle) on a sample of joint stock companies in Saudhi Arabia. The study found significant negative relationship between the firm's profitability and its liquidity level, as measured by the current ratio.

Shin and Soenen (1998) highlighted that efficient working capital management was very important for creating value for the shareholders. They found a strong negative relationship between lengths of the firm's net trading cycle and its profitability. In addition, shorter net trade cycles were associated with higher risk adjusted stock returns.

Smith and Bengemann(1997) study results showed that a traditional working capital leverage ratio, current liabilities divided fund flow, displayed the greatest association with return on investment. Well known liquidity concepts such as the current and quick ratios registered insufficient association whilst only one of the newer working capital concepts, the comprehensive liquidity index, indicated significant relationship with return on assets.

RESEARCH METHODOLOGY
The information required for this study has been collected from the annual reports of MAA **FRUITS INDIA Pvt., Ltd.,** from **2002-2003 to 2005-2006**. For the purpose of analysis the efficiency of liquidity management of **MAA FRUITS**, the technique of ratio analysis, Motaal's comprehensive rank test, statistical techniques like averages, standard deviation, co-efficient variations, Spearman's rank correlation etc, have been used in this study to test the significance of relationship between liquidity and profitability. Student test as also been used.

OBJECTIVES OF THE STUDY
1. To understand the quantum of liquidity maintain by the **MAA FRUITS INDIA Pvt., Ltd.,** and to analyze the amount tied-up in various component of working capital.
2. To examine the pattern of the liquidity position during the period under the study on the basis of certain parameters of liquidity management.
3. To compare the liquidity position from year to year by applying Mortaal's Comprehensive test.
4. To measure the extent of relationship between liquidity and profitability by using Spearman's rank correlation co-efficient and also to test the significance of such correlation co-efficient.
5. To provide suggestions wherever necessary to improve the efficiency of liquidity management of **MAA FRUITS INDIA Pvt., Ltd.,**

MEASUREMENT OF LIQUIDITY
The measure of liquidity helps to indicate the level of solvency and financial flexibility of the firm. In order to ensure a desire level of solvency and provide to enough financial flexibility to attain the strategic goals of the enterprise, the following important liquidity ratios are used to measure the liquidity of a concern.

RATIOS
A. Current Ratio
B. Liquidity Ratio
C. Cash Position Ratio
D. Stock Ratio
E. Debtor Velocity Ratio
F. Current Assets to Total Assets Ratio

LIQUIDITY MANAGEMENT AT MAA FRUITS INDIA PVT. LTD.
For this study the researcher has collected the data regarding liquidity position maintained by the company during last four years (2002- 2003 to 2005 – 2006) and the relevant ratio's measuring the above have been given in the following paragraphs apart from interpretation of the concerned.

TABLE 1: Liquidity ratios of MAA FRUITS INDIA Pvt., Ltd., from 2002 – 2003 to 2005 – 2006

Period	C.R	Q.R	C.P.R	C.T.T.R	I.T.R	D.T.R
2002 – 03	3.93	1.02	0.09	0.73	4.66	57.47
2003 – 04	1.72	0.37	0.01	0.75	16.60	28.12
2004 – 05	1.67	0.43	0.04	0.51	25.89	13.05
2005 – 06	3.27	1.33	0.25	0.76	9.42	43.09
Average	2.65	0.79	0.098	0.69	14.14	35.43
S.D	0.98	0.40	0.09	0.10	8.004	16.57
C.V (%)	36.98	50.63	91.83	14.49	56.61	46.77

Source: Computed from the annual reports of MAA FRUITS INDIA Pvt., Ltd., from 2002-03 to 2005-06 CR= Current Ratio; QR= Quick Ratio; CPR=Cash Position Ratio (Cash to C. Liabilities) CTTR=Current Assets to Total Assets Ratio; ITR=Inventory Turnover Ratio; DTR= Debtors Turnover Ratio.

A. CURRENT RATIO (CR)

Current Ratio (CR) is an important measure of analyzing the firm's ability to pay off its current obligations out of its short-term resources. Thus it indicates the relationship between current assets and current liabilities of a company. The higher the CR, the higher is the amount available per rupee of current obligations and accordingly, the higher is the feeling of safety and security. The rule of thumb about the CR is 2:1. The logic underlying this rule is that even when the assets realized 50% of their book valued (due to force sales) yet the proceeds would be adequate to meet short-term obligations. However, this rule is not a general guide and applicable to all types of businesses. Each firm should develop its own standard for CR from past experience.

The data in table 1 revels that current ratios in MAA FRUITS INDIA Pvt., Ltd., registered a fluctuating trend during the period under the study it various from 1.67 to 3.93. On an average the CR of the company was 2.65 during the period under the study. Its shows the CR are slightly more than the ideal CR of 2:1. It indicates it has maintained good liquidity positions. From the above calculated CR we could say that the Liquidity position of the company was satisfactory. The higher the current ratios, the more liquid the firm. However a higher CR of an indicates lower profitability of the firm. So it needs a further analysis of quality of short-term assets.

B. QUICK RATIO (QR)

This ratio is widely used parameter of judging the short-term repaying ability of a firm in the near future. The rule of thumb about quick ratio is 1:1. This ratio is a refinement over current ratio as its consider the quality of current assets. The exclusion of inventory is based on the fact that it cannot be easily and readily converted in to cash. Prepaid expenses by their very nature cannot be used for payment of current obligations. Quick or liquid liabilities refer to those current liabilities, which are required to be paid off immediately or at short notice. The exclusion of bank overdraft is due to the fact that it tends to become a permanent mode of financing.

It is evident from the table 1 that the quick ratio also marked fluctuating trend during the period under the study and ranged from 0.37 in 2002 – 2003 and 1.33 in the year 2005 – 2006. On an average the quick ratio in MAA FRUTIS INDIA Pvt., Ltd., was 0.79 nearing to the conventional norm of 1:1 through out the period study. It clearly indicates that the absolute liquidity position of the company was almost satisfactory. So on can infer that through out the period under the study particularly 2002 – 2003 and 2005 – 2006, the liquid assets of MAA FRUITS INDIA Pvt., Ltd., were improve and there are more than adequate assets to meet its short-term obligations.

C. CASH POSITION RATIO (CPR)

This ratio is also called as Super Quick Ratio and is a more rigorous test of liquidity position of a firm. Absolute liquid assets (Cash in hand, Cash in Bank and Marketable Securities) are divided by current liabilities for computation of this ratio. CPR is interpreted in respect of current obligations. A high CPR is good from the creditor's point of view whereas from the management point of view it indicates poor investment polices.

Table1 depicts the fluctuating cash position ratio trend during the period under study ranging from 0.01 in the year 2003 – 2004 to 0.25 in the year 2005 – 2006. On an average the ratio was 0.098 during the period of the study. This ratio was almost nearing to the average ratio in the year's 2002 – 2003 and 2003 – 2004 (2 years out of the total 4 years) the conventional norm is 50% or 0.5:1 it means their should be Rupee's one worth absolute liquid assets are considered adequate to pay Rupee's two worth current liabilities in time. The study indicates that the company never had the Cash position ratio 0.5:1. It indicates that the management of cash was poor in company.

D. CURRENT ASSETS TO TOTAL ASSETS (CTTR)

This ratio explains the extent of total funds invested for working capital purpose. 1 presents current assets to total assets ratio (CTTR) recorded almost fluctuations during the period under the study. It was high as 0.76 in 2005 – 2006 and as low a s0.51 in 2004 – 2005. The fluctuation in the ratio was not much expected in the year 2004 – 2005. The average percentage of current assets in relation to total assets was 0.69 which should that nearly 70% of funds remind tied up in working capital and about 30% remind invested in permanent assets during the period under the study.

E. INVENTORY TURNOVER RATIO (ITR)

This ratio throws light on the inventory control policy adopted by a concern. This ratio shows the relationship between the cost of goods sold during a particular year and inventories kept by a concern during that year. Higher ITR shows a higher efficiency of the management and vice-versa.

It is evident from table 4.1 that inventory turnover ratio registered increasing trend during the period under the study except in the year 2005 – 2006. The highest ratio was 25.89 registered in the year 2004 – 2005 and lowest was 4.66 registered in the year 2002 – 2003. The average of this ratio was 14.14 during the period under the study. It is observed from the table 1 that this ratio has improved from 4.66 in the year 2002 – 2003 to 25.89 in the year 2004 – 2005. It is thus clear that the management tried to control its inventory levels to a great extent during the period of the study. In the year 2005 – 2006 it was 9.42 which is lower when compared to the preceding two years. This is due to excess stock and accumulation of absolute stock. This is an indicator of dull business, accumulation of inventory, over investment in inventory, and unbalanced inventory, etc. In the years 2003 – 2004 and 2004 – 2005 the stock has been efficiently used and in the year 2005 – 2006 it was not much. However the inventory management of **MAA FRUTIS INDIA Pvt., Ltd.,** in general was satisfactory during the period under study wand was more efficient in the year 2003 – 2004 and 2004 – 2005.

F. DEBTOR'S TURNOVER RATIO (DTR)

This ratio throws light on the credit and collection policy pursued by a concern. DTR is an important tool of analyzing the efficiency of liquidity position of a company. The Liquidity position of a company depends on the quality position of a company depends on the quality of debtors to a great extent. It measures the rapidity or the slowness of their collectibles. The high DTR implies the prompt payments made by debtors and vice – versa. According to the study conducted by CMIE (Centre for monitoring Indian Economy), average DTR of level is consider to be satisfactory in an Indian manufacturing company (CMIE 1998).

It can be seen from the table 1 that the debtor's turnover ratio was 13.05 in the year 2004 – 2005 which is highly satisfactory compared to other year. In the years 2002 – 2003 and 2005 – 2006 the debtors took more than 43 days to pay there debts to the company. In other way this indicates the company followed the liberal credit policy to collect the cash from debtors or the company had not taken appropriate collection efforts.

TABLE 2 RANKING IN ORDER OF LIQUIDITY OF MAA FRUITS INDIA PVT., LTD., FROM 2002 – 03 TO 2005 - 06

Year	NWC to C.A		Inventory to C.A		Liquid Assets to C.A		Loans and Advances to C.A		Total Ranks A+B+C+D	Total Ultimate
	%	Rank A	%	Rank B	%	Rank C	%	Rank D	Total	Rank
2002 – 03	74.54	1	74.10	3	25.89	2	3.64	1	7	4
2003 – 04	41.71	3	78.21	1	21.79	4	2.24	3	11	2
2004 – 05	39.99	4	74.29	2	25.70	3	2.51	2	11	2
2005 – 06	69.42	2	59.27	4	40.73	1	1.28	4	11	2

Source: Computed from Annual Reports of MAA FRUITS INDIA Pvt., Ltd., from 2002 – 03 to 2005 – 06

TABLE 3: RANK CORRELATION BETWEEN LIQUIDITY AND PROFITABILITY OF MAA FRUITS INDIA PVT., LTD., FROM 2002 – 03 TO 2005 - 06

Year	Current Assets to Total Assets (CTTR) %	CTTR Rank (R-1)	Return on Capital Employed (ROCE)%	ROCE Rank (R-2)	R1-R2 D	D^2
2002 – 03	73	3	-4.52	4	-1	1
2003 – 04	75	2	1.39	3	-1	1
2004 – 05	51	4	4.40	2	2	4
2005 – 06	76	1	7.99	1	0	0
Total						$\sum D^2 = 6$

Source: Computed from Annual Reports of MAA FRUITS INDIA Pvt., Ltd., from 2002 – 03 to 2005 – 06

$$R = 1 - \frac{6\sum D^2}{N(N^2 - 1)}$$

$$= 1 - \frac{6 \times 6}{4(4^2 - 1)}$$

$$= 0.4$$

In table 1 an effort has been made to measure the consistency among all six parameters of liquidity management more precisely by applying the co-efficient of variation (C.V). The C.V is the most commonly used statistical method where the variability between two or more variables is compared. The variable for which the C.V is grater is said to be fluctuating or conversely less consistent, less stable, less uniform. On the other hand the variable for which C.V is less it is regarded as less fluctuating or more consistent, more stable or more homogeneous.

Table 1 revels that out the six different parameters of liquidity management, the co-variation is low in case of current assets to total assets ratio. If the current assets to total assets ratio is variable it meets that it is more consistent and stable with 14.49. At the same time cash position ratio is more variable and less consistent with 91.83. The remaining ratios trend has been followed lower to higher degree are that is 36.98 (Current Ratio), 46.77 (Debtors Turnover Ratio), 50.63 (Quick Ratio), and 56.61 (Inventory Turnover Ratio) respectively. The cash position ratio (CPR) in MAA FRUITS INDIA Pvt., Ltd., is less consistent. It further supports debtor's turnover ratio (DTR), Inventory Turnover Ratio (ITR), Current Ratio (C.R) and Quick Ratio (Q.R). The C.V is fluctuating ranges in between lower 14.49 and higher 91.83 variations.

MOTAAL'S COMPREHENSIVE TEST

Motaal's Comprehensive Test method of ranking has been applied to reach at a more comprehensive assessment of liquidity in which four different ratios's viz, networking capital to current assets ratio, inventory to current assets ratio, liquid assets to current assets ratio and loans and advances to current assets ratio have been computed and combined in a points score. A high value of networking capital to current assets ratio or liquid assets to current assets ratio shows greater liquidity and accordingly ranking has been done in that order. On the other hand, a low inventory to current assets ratio or loans and advances to current assets ratio indicates more favorable liquidity position and there fore, ranking has been done accordingly in that order. Ultimate ranking has further being done on the basis that the lower the total of individual ranks, the more favorable is the liquidity positions of the concern and vice versa.

Table 2 furnishes that in MAA FRUITS INDIA Pvt., Ltd., the years 2003 – 2004, 2004 – 2005 and 2005 – 2006 marked the most sound liquidity position and it was followed by the year 2002 – 2003.

CO-EFFICIENT OF RANK CORRELATION AND TESTING THE SIGNIFICANCE

Table 3 reveals the extent of relationship between liquidity and profitability of MAA FRUITS INDIA Pvt., Ltd., by computing Spearman's Rank Correlation Co-efficient.

An attempt has also been made to test whether the computed value of such correlation co-efficient is significant or not, student's "t" test has further been applied for this purpose the ratio of current assets to total assets (CTTR) has been used as the liquidity indicator and the ratio of return on capital employed (ROCE) of the company was 0.40.

The Student's "t" test proves that the correlation co-efficient between current assets to total assets (CTTR) and return on capital employed (ROCE) is statistically not significant. It is therefore concluded that the liquidity and the profitability move in the opposite direction.

TESTING THE SIGNIFICNCE OF CORRELATION CO-EFFICIENT

H_0 = Null hypothesis – There is no correlation between the ranked data of MAA FRUITS INDIA Pvt., Ltd.,

H_1 = Alternative hypothesis – There is correlation between the ranked data of MAA F RUITS INDIA Pvt., Ltd.,

$$t = \frac{r}{\sqrt{1 - r^2}} \times \sqrt{n - 2}$$

Where r = 0.40, n = 4

$$= \frac{0.40}{\sqrt{1 - (0.40)^2}} \times \sqrt{4 - 2}$$

$$= 1.5315$$

$$V = n - 2 = 4 - 2 = 2$$

$$t_{0.05} = 4.303$$

The calculated value of "t "is lower than the table value. The hypothesis is accepted that there is no correlation between the ranked data of MAA FRUITS INDIA Pvt., Ltd.,

SUMMARY OF FINDINGS, SUGGESTIONS

FINDINGS

- The company had higher current ratio in the years 2002 – 2003 and 2005 – 2006 more than the conventional norm of 2:1. The higher current ratio indicates more liquidity position than required and lower profitability position. This is not a good sign. In the years 2003 – 2004 and 2004 – 2005 the current ratio touched almost the conventional norm. Which mean the company enjoyed sufficient liquidity to meet its obligations.
- The study shows that the company enjoyed absolute liquidity position during the period under study. Though there was fluctuation in the ratio, on the whole it was satisfactory and this ratio was more than conventional norm of 1:1 in 2002 – 2003 and 2005 – 2006.
- The Study indicates the cash management of the company is poor which is revealed by the cash position ratios of different years.
- The firm invested almost 70% of funds in current assets.
- The study shows the inventory turnover ratio registered an increasing trend from the first year except the last year (2005 – 2006) which means that the management has try to maintain good inventory levels in the first 3 years of study and the last year the ratio was poor due to dull business, accumulation of more inventory etc.
- The company followed liberal credit policy with regards to collection of due from its debtors except in the year 2002 – 2003 where the company was able to collect the dues from debtors quickly.
- The Motaal's comprehensive test applied in the study shows that the company enjoyed most sound liquidity position in the year's 2003 – 2004, 2004 – 2005 and 2005 – 2006.
- The student "t" test applied in the study to test the relationship between liquidity and profitability using rank correlation calculated proves to be statistically not significant.

SUGGESTIONS

- The company should try to maintain stability with respect to current ratio.
- The company should have sufficient absolute liquid assets like cash, bank balances to meet its day to day expenses and payment of bills payable in time. The study shows that the cash management by company was poor. In the light of this situation, the company has to take care of cash management properly for which it needs to plan cash requirements for short term properly.
- The company could spent some more portion of fixed capital as investment in fixed assets which are used for production purpose, that give good return on the investment.
- The company should have some what stringent credit policy compare to the existing credit policy to collect the dues from debtors without loosing customer's loyalty.
- The company should see that inventory is not accumulated to much and ensure its fast conversion.

CONCLUSION

The Brand MAA is trying to compete with the other equally popular brands like Appy, Frooti, Maaza, Fruitnik, etc in terms of sales and market shares. The company MAA FRUITS INDIA Pvt., Ltd., during the study period maintained sound liquidity positions. But incase of certain liquidity measurement ratios like cash position ratio, consistency in the above aspects and try to maintain good cash position and speed up the cash collection for which it need's to revamp its credit policy and cash planning in the future. On the whole the company's liquidity management was almost satisfactory.

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Hoping an appropriate consideration.

With sincere regards

Thanking you profoundly

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Sd/-

Co-ordinator