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EFFICIENCY OF WORKING CAPITAL MANAGEMENT PRACTICES AND FINANCIAL VIABILITY- AN APPRAISAL

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KEYWORDS :

INTRODUCTION :

Performance does mean action or achievement. It could also be said as the ability to move quickly or operate something efficiently. Financial performance is the right tool for judging the working efficiency of any organization irrespective of the nature. To measure the financial performance, in general, business enterprises use financial analysis tools. The financial analysis provides a method for assessing the financial strengths and weaknesses of a firm with a view to understand the firm's current financial condition, which, in turn, could serve as the basis for decision making.

Interpretation of financial statement is an intellectual process with a view to forming an opinion on the value of its business. It guides the present arid prospective shareholders and creditors to understand the operations of a business enterprise in a highly competitive economy. It is only the searching analysis of the published accounts that brings to light any camouflage that might have been practiced by the people.

Primary goal of a financial manager is to maximize the stock price however accounting data do influence stock prices and to evaluate the performance of a company in such a way by analyzing the accounting statements. In the first place, interpretation of financial statements and their review by business executives compel them to think ahead and provide for future.

Skilled workforce, low cost of operations. moving up the value chain, growing geographical reach and internationalization are some of the factors helping the industry to maintain the growth momentum, however one of the important influencing factor of earnings of a corporate enterprises is working capital. From the point of view this chapter focuses with the analysis of working capital practices followed, measurement of working capital efficiency and examination of financial viability.

OBJECTIVES OF THE STUDY

Following are specific objectives of the study.

- To study the growth and development of Indian Software Industry.
- To examine the consistency and growth rate of selected financial parameters of the particular software companies.
- To test the equality of variance, to examine the mean differences and to forecast the trends of the selected variables between the selected groups
- To examine the overall contribution of selected financial parameters and clustering them into groups, to identi1, the most influencing factor towards earnings and classify the companies into groups by applying discriminate analysis..
- To study the working capital practices followed and to examine the efficiency of working capital management.

METHODOLOGY:

SOURCES OF DATA

Secondary data are used in this study, which were collected from the corporate database and PROWESS of the Centre Mr Monitoring Indian Economy. Variables pertaining to behaviour of liquidity, leverage and profitability were collected from the balance sheet and profit and loss account of the selected software companies for a period of ten years i.e., from the financial period 2001-02 to 2011-12. Besides the corporate database, reports were collected from RBI Bulletin, Annual survey of Industries, Libraries of various institutions and Research publications. The above data has been processed as per the study objectives.

SELECTION OF THE SAMPLE

- The present study is limited to the software industry /IT sector companies in India.
- Continuous data available for all the ten accounting years.
- The companies' shares were actively traded in Bombay Stock Exchange.
- The companies for which the data were not available for one and more than one year in between or in the beginning or at the end of the study period have been ignored.

HYPOTHESES

The following hypotheses have been framed in consonance with the objectives of the study.

1. There is no significant difference in the mean total assets/properties among different groups of companies.
2. There is no significant difference in the mean net worth among several groups of companies.
3. There is no significant difference in the mean net sales/turnover among different groups of companies.
4. There is no significant difference in the mean earnings before interest and taxes/statutory deductions among different groups of companies.

ANALYSIS OF WORKING CAPITAL MANAGEMENT

Working capital in a business is considered as life-blood in human body. It could be defined as the portion of assets used in current operations. Movement of funds from working capital to profit and back to working capital is one of the most important characteristics of a business. This cycle operation is concerned with utilization of funds with an additional amount called income. If operations of a company run smoothly then a proper relationship between fixed capital and current capital is to be maintained.

Sufficient liquidity is important it must be achieved and maintained to provide that funds to pay off obligations as they arise or mature. The adequacy of cash and other current assets together with their efficient handling, virtually determine the survival or demise of a company. A businessman should be able to judge the accurate requirement of working capital and should be quick enough to raise the required funds to finance the working capital needs.

"Working capital is also called net current assets it is the excess of current assets over current liabilities. All organizations have to carry working capital in one form or the other. The efficient management of working capital is important from the point of view both liquidity and profitability. Poor management of working capital proves that funds are unnecessarily tied up in form of idle assets it reduces liquidity and alsothe ability of investment in productive assets such as plant and machinery."

Working capital management refers managing the working capital. To be more precise it is the management of current assets. A firm's working capital consists of its investments in current assets, which include short-term assets such as cash and bank balance, inventories, receivables and marketable securities. So working capital management refers to the management of the level of all these individual current assets. The need of working capital management arises from two considerations. (i) existence of working capital is imperative in a firm the fixed asserts, which usually require a large chunk of total funds, could be used at an optimum level if supported by sufficient working capital (ii) it involves investment of funds of a firm. If working capital level is not properly maintained ten it results in unnecessary blocking of scare resource of the firm. Insufficient working capital, in the other hand put different hindrances in smooth workings of a firm. Therefore, working capital management needs attention of all the financial managers.

The variables like current assets, current liabilities, sales working capital, working capital ratio. Working capital turnover ratio current assets to sales ratio, current assets to total assets ratio,, return on investment were taken and analyzed with the help of simple summary statistical and ratios.

RESULTS OF DATA ANALYSIS

Summary Statistics of Current Assets

It is evident from table 4.1 that the size of current assets has increased from Rs 34.05cr in 1995-96 to Rs 345.07cr in 2004-05, the increase is 10.13 times and registering a compounded annual growth rate of 30.06 per cent. Moreover, increase in current assets has been regular throughout the period. During 1999-2000 it is observed a consistent performance in current assets.

Summary Statistics of Current Liabilities

Exhibits the size of current liabilities during the study period. There is an increasing trend is observed from 1995-96 to 2004-05. It shows compounded annual growth rate of 31.98 per cent. During 1998-99 a least variation and consistent performance is observed. When compared the current liabilities with current assets, current assets represents a significant volatility.

Summary Statistics of Working Capital

Presents the size of working capital position is in increasing trend during the study period due to increase in current assets. Size has been increased from R.34.05 cr to R.203.33 cr. The table represents that variability in working capital is less in the year 1999-2000 compared to other periods. The compounded annual growth rate is 26.29 per cent.

Summary Statistics of Sales

It is observed from table 4.4 that sales has been increased from Rs.59.82cr to Rs.468.83cr, which shows sales has increased consistently during the year 1999-2000 and it is inconsistent during the year 2004-05. The compounded annual growth of sales is 26.18 percent.

Summary Statistics of Current assets to Sales ratio

This ratio indicates the efficiency with which working capital turns into sales. A lower ratio implies by and large a more efficient use of funds. A high turnover. ratio indicates reduced lock up of funds in working capital. An analysis of current assets to sales ratio over a period of time shows the overall efficiency of working capital management of a firm. It is clear from table 4.5 the ratio of current assets to sales has been increased from 149.88 per cent to 874.77 per cent between 1995-96 and 2004-05. During the study period sales as well as current assets are increased. During 1995-96, 1996-97, 2000-01 and 2001-02 there is efficient application of funds were found when compared to other years. It is observed that the compounded annual growth rate is 81.99 per cent indicates that inefficient of management of current assets and it causes lock up of funds in working capital it is reflected in working capital turnover ratio.

Summary Statistics of Working capital ratio

It is a yardstick to measuring short-term solvency of the company i.e its ability to meet short-term obligations. It indicates the rupee of current assets available for each rupees of current liabilities and obligations. During the study period a sound working capital is observed in all the years. From table 4.6 a compounded annual growth rate of 26.99 per cent is observed during the period. A highest ratio is observed in the year 2001-02, higher liquidity signifies idle funds, which will reduce profitability.

Summary Statistics of Working capital turnover ratio

Working capital turnover ratio explains the liquidity position of a company and also the velocity of the utilization of net working capital. The ratio indicates the number of times the working capital is turned over in a year and it measures the efficiency with which working capital is used by the firm. A higher ratio indicates the efficient utilization of working capital and low ratio indicates otherwise but very high working capital turnover ratio is not good situation for a firm. Working capital turnover ratio is calculated on the basis of cost of sales divided by average working capital. Compounded annual growth of working capital turnover ratio is —5.49 per cent. Table 4.7 reveals the trend of the working capital turnover ratio during the study period and it is clear that the ratio to be improved.

Summary Statistics of Current assets to Total assets ratio

This ratio indicates the funds invested as working capital. It indicates the proportion of current assets to total assets. Mean performance of the ratio is presented in table 4.8 and a highest mean percentage is observed in the year 1995-96. From 1995-96 to 2000-01 a major portion of amount is invested in current assets when compared to fixed assets. After 2001 the contribution of investment in current assets has been decreased and it ranged from 58.37 per cent to 69.14 per cent. Higher investment in current assets leads to increase liquidity and decrease profitability and it causes a low return on assets. As funds tied up in idle cash and high levels of debtors reduce profitability in turn cost of liquidity increases with increase in current assets. From the year 2001-02 to 2004-O5consistency is observed from contribution of current assets to total assets.

Association between Liquidity and Profitability by applying Spearman's Rank Correlation

In order to measure the strength of linear relationship between a paired set of such variables, spearman's rank correlation coefficient is used. This is a measure of the correlation that exists between the two sets of ranks. In particular the rank correlation coefficient determines the extent to which the two sets of rankings are in agreement or in disagreement.

From this point of view to examine the association between liquidity and profitability Spearman's Rank Correlation is used.

The rank correlation is calculated as

$$R = 1 - \frac{6\,[\sum d^2]}{N^3 - N}$$

Where

R denotes rank coefficient and d refers to difference between ranks. N denotes number of paired items in the series.

SUMMARY OF FINDINGS :

At corporate level globalization takes place when companies decide to participate emerging global economy and establish themselves in foreign markets. First they have to produce the goods and services required for customers in the global market., and then they might take advantage of the Internet revolution and establish a virtual presence on the international market place with a multilingual corporatism.

Performance of a company is measured in financial net results , the success of the firm depends on how several internal and external factors. Ibternal factors are ability of the management, vision and mission of the board of directors and value chain components, The external factors are government policies, fiscal and monetary policies, threat from competition etc. The managing finance is much more complicated and faster faces today. Important and swift development in the field of finance and application of new technology such as e banking and internet banking etc in decision making environment yield new challenges and opportunities for financial managers knowledge of all these developments and their impact is necessary for the effective management and financial viability of the modern business firms. Financial managers need to know how effective decisions can be made and ineffective ones be avoided.

CONCLUSION

Due to economic globalization , there is a competition not only just between companies, but also countries as well. India should be aware of the global competition it faces and create a value proposition to help it for survival.. To achieve this, an environment that cherish not only for established firms like Infosys and Wipro but also start-ups and small innovative companies. The winning strategy lies in focusing the hardest on opportunity by analyzing strength, weaknesses, opportunities and threats of the company. While some companies that will break into ranking the Indian software industry has achieved a greater heights to reach this level and tougher challenges are ahead in terms of growing competition from multinationals in India. While the going will be tough for most, this sector is here to stay and remain a prime property for both investors' interest and entrepreneurial activity. Nevertheless, the top companies continued to expand their capacity and bid for larger contracts. Smaller firms hit by the slowdown have been away from setting up new facilities and focused on conservating capital. Falling margins, merger and acquisition, diversifications into related areas like business process outsourcing offshore reflect the growing maturity of the sector in India.

SUGGESTIONS :

This part is concerned with few suggestions from the above observations relating to the study are given to improve their operational efficiency.

The following are the suggestions given to the industry based on the data analysis and interpretation:

- The slowdown has, however, curbed fresh investments in fixed assets as many companies have under utilized infrastructure.
- The large groups of companies are suggested to minimize their long- term debt utilization.
- The small groups of companies are suggested to maximize their capital employed to get survive.
- The large and medium groups of companies are suggested to minimize their operational expenses.
- Mergers and acquisitions help the large and giant groups to get compete with the multinationals.

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