PARIPEX - INDIAN JOURNAL OF RESEARCH | Volume - 10 | Issue - 06 | June - 2021 | PRINT ISSN No. 2250 - 1991 | DOI : 10.36106/paripex

ORIGINAL RESEARCH PAPER

Commerce

PERFORMANCE ASSESSMENT OF ITC LTD THROUGH LIQUIDITY & PROFITABILITY RATIOS

KEY WORDS: liquidity, profitability.

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ABSTRACT

This paper helps in understanding the relationship between the liquidity and profitability position of ITC Ltd. An optimal liquidity position and working capital position is beneficial for any organization. Liquidity and profitability can have an immediate relationship and can have a direct impact on each other. In this paper we have analyzed the liquidity position and profitability position of ITC ltd covering a period of five years from 2014-15 to 2018-19. liquidity position has been measured in terms of Current ratio, Quick ratio whereas profitability is measured on the basis of gross profit ratio, net profit ratio, etc. Pearson's correlation and analysis are used in the study.

INTRODUCTION

Optimum working capital is required for maintaining the day-to-day operations of an organization. In order to maintain this the financial experts must ensure that the organization is progressing in efficient and profitable manner and must ensure that the current assets & current liabilities are handled adequately. This affects business organizations growth and profitability position. The financial experts puts a lot of emphasis on working capital decisions. The reason behind this is that current assets are short-lived investments whereas the current liabilities has to be paid on a timely basis to maintain the credit worthiness of an organisation. Liquidity for the ongoing business enterprise is not dependent on the liquidation value of its assets, but rather on the operating cash flows generated by those assets. Hence we can conclude that decisions on the level of different working capital components become frequent, repetitive, and time consuming. It can be further stated that working capital management is an important area in the field of financial management and profitability has a close relationship with it and can have a direct impact on each other.

OBJECTIVES OF STUDY

The following objectives are fulfilled:

(I) To analyze the concept of liquidity & profitability of ITC Ltd.
(ii) To examine how far liquidity has an impact on profitability of ITC Ltd.

Hypothesis

In order to achieve these objectives, the following null hypothesis is framed for testing:

(I) There is no significant impact of current assets on the profitability position of ITC LTD from the year 2014-15 to 2018-19.

Limitations

The following are the limitations of this study

(i) Our analysis is based on financial information
(ii) The data has been grouped and sub grouped
(iii) Our study is based on secondary data only.
(iv) In case of any uneven trend beyond or before the period is not considered and covered

Research Design

The research design is needed for the smooth conduction of various research operations so that the collected data could be used efficiently and effectively to carry out the research. For this study the research design includes liquidity analysis & profitability analysis of ITC Ltd which is based on various liquidity and profitability ratios. The figures are taken from the organization's Annual report which contains Annual Balance Sheet, Profit & Loss Account. The collected data has been processed by preparing the tables and the ratio analysis is applied. We have tried to avoid personal bias while interpreting the ratios. We have taken various statistical tools such as mean, standard deviation, co-efficient of variation, correlation & t-test so that the calculated information is in accordance with predefined standard of accuracy.

Performance Assessment through Liquidity & Profitability ratios

1. Current Ratio

The Current ratio helps in assessing the short term solvency position of a business enterprise. If this ratio is high it indicates that solvency position is sufficient to meet the short term liabilities and vica- versa.

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

TABLE NO. 1: Statement Showing Current Ratio (Rs. In Crores)

Year	Current Assets	Current Liabilities	Current Ratio
2014-15	23955	11681	2.050766202
2015-16	22933	6355	3.608654603
2016-17	24537	6830	3.592532943
2017-18	24503	8857	2.766512363
2018-19	29570	9622	3.073165662
Mean	25099.6	8669	3.018326354
S.D	2581.723804	2165.191331	
CV	10.28591613	24.97625252	

Source: Compiled from Annual report of the ITC Ltd.

Interpretation

As per the above table the current ratio of this organization seems to be very fluctuating . Initially it was at 2.05:1 and it got increased to 3.59:1 by 2016-17. There was decrease in this ratio as it was at 2.76 :1 by 2017-18 and got increased at 3.07 : 1 in the last year. The mean was at 3.01: 1.

2. Liquid Ratio

The liquid ratio helps in knowing the organizations capacity to pay short term obligations as soon as it is due. Stock & prepaid expenses are not included in liquid assets as they cannot be converted into cash in a short period of time. This ratio compliments the current ratio.

$$\text{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Current Liabilities}}$$

Liquid assets = Current assets – (Stock + Prepaid expense)

TABLE NO. 2: Statement Showing Liquid Ratio (Rs. In Crores)

YEAR	Liquid Assets	Current Liabilities	Quick Ratio
2014-15	16119	11681	1.379933225
2015-16	14414	6355	2.268135327
2016-17	16674	6830	2.441288433

2017-18	17269	8857	1.949757254
2018-19	21983	9622	2.284660154
Mean	17291.8	8669	2.064754879
S.D	2830.492307	2165.191331	
CV	16.36898592	24.97625252	

Source: Compiled from Annual report of the ITC Ltd.

INTERPRETATION

As per the above table no.2, the quick ratio of this organization seems to be increasing initially as it was at 1.37:1 and it got increased to 12.44:1 by 2016-17. There was a decrease in this ratio as it was at 1.94:1 by 2017-18 and it was at 2.28 in the last year. The quick ratio was more than the ideal ratio of 1:1 throughout the study period .The mean was at 2.06 : 1.

Working capital turnover Ratio

The Working capital turnover ratio helps in studying the utilization of working capital & it indicates the number of times the working capital is rotated in the course of a year. Higher ratio indicates greater utilisation of working capital efficiently and vica- versa.

$$\text{Working capital turnover Ratio} = \frac{\text{Cost of goods sold}}{\text{Working capital}}$$

TABLE NO. 3: Statement Showing Working capital turnover Ratio (Rs. In Crores)

YEAR	Cost of goods sold	Working Capital	Working Capital Turnover Ratio
2014-15	10987.83	12274	0.89521183
2015-16	11054.75	16578	0.666832549
2016-17	11765.56	17707	0.664458124
2017-18	11765.21	15646	0.751962802
2018-19	13184.97	19948	0.660967014
Mean	11751.664	16430.6	0.727886464
SD	883.7242479	2824.710038	
CV	7.51999247	17.19176438	

Source: Compiled from Annual report of the ITC Ltd

INTERPRETATION

As per the above table no.3 the working capital turnover ratio of this organization seems to be fluctuating . Initially it was at 0.89 times and it got increased to the maximum at 0.75times by 2017-18. There was decrease in this ratio as it was at 0.66 times by 2018-19 in the last year. The mean was at 0.72 times.

4. GROSS PROFIT RATIO

In order to study the relationship between the gross profit and net sales this ratio is calculated. A higher percentage reflects the efficiency of the organization and a lower ratio reflects inefficiency of the organization.

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}} * 100$$

TABLE NO 4 STATEMENT SHOWING GROSS PROFIT RATIO

Year	Gross Profit	Net Sales	Gross Profit Ratio
2014-15	38976.99	49964.82	78.00886704
2015-16	40889.82	51944.57	78.71817978
2016-17	43682.9	55448.46	78.78108788
2017-18	32564.56	44329.77	73.45979914
2018-19	32599.42	45784.39	71.2020407
Mean	37742.738	49494.402	76.03399491
S.D	4999.506854	4530.812171	
CV	13.24627496	9.154191157	

Source: Compiled from Annual report of the ITC Ltd

Interpretation:

The gross profit ratio is reflecting an upward trend initially as it was at 78.00 % in the year 2014-15 and it got slightly increased to 78.78 % in the year 2016-17. There was a huge dip in this ratio in the last year as it reached to 71.20 % . The mean of gross profit ratio was at 76.03 %.

5. NET PROFIT RATIO

To study the relationship between the net profit and net sales this ratio is applicable. A higher reveals adequate profitability position and the lower ratio indicates that cost of production and the indirect expenses needs to be controlled by the business enterprise.

The formula for calculating the net profit ratio is:

$$\textbf{Net Profit Ratio} = \frac{\text{Net Profit}}{\text{Net Sales}} * 100$$

Table No 5 STATEMENT SHOWING NET PROFIT RATIO

Year	Net Profit (Rs)	Net Sales	Net Profit Ratio
2014-15	9608	49964.82	19.2295299
2015-16	9328	51944.57	17.95760365
2016-17	10201	55448.46	18.39726478
2017-18	11223	44329.77	25.31707248
2018-19	12464	45784.39	27.22325229
Mean	10564.8	49494.402	21.62494462
S.D	1286.242473	4530.812171	
CV	12.17479245	9.154191157	

Source: Compiled from Annual report of the ITC Ltd

Interpretation:

The net profit ratio is also reflecting an upward trend as it was at 19.22 % in the year 2014-15 and it got increased to 25.31% in the year 2017-18. There was a further increase in this ratio in last year as it stood at 27.22 % . The mean of net profit ratio was at 21.62 %.

TABLE NO.6 STATEMENT SHOWING THE RELATIONSHIP BETWEEN CURRENT ASSETS AND NET PROFIT

YEAR	Current Assets	% change	Net profit	% change
2014-15	23955		9608	
2015-16	22933	-4.26	9328	-2.91
2016-17	24537	6.99	10201	9.35
2017-18	24503	-0.13	11223	10.01
2018-19	29570	20.67	12464	11.05
Mean	25099.6		10564.8	
S.D	2581.723804		1286.242473	
CV	10.28591613		12.17479245	

Source: Compiled from Annual report of ITC Ltd

Interpretation

As per the above table it was found that the current assets had shown a mixed trend as it was at -4.26 % in the year 2014-15 but it got increased to 6.99 % in the very next year and it increased to the maximum at 20.67 % by 2018-19. It was also found that the net profit had also shown an increasing trend as it was at -2.91 % in the year 2014-15 but it got increased to 9.35 % in the year 2016-17 and it was at the highest at 11.05 % by 2018-19.

FINDINGS AND SUGGESTIONS

TESTING OF HYPOTHESIS

In this study for testing the hypothesis correlation & t- test have been applied and the reliability of data has been tested at 5% level of significance.

Null Hypothesis

$\mathbf{H_{01}}$ There is no significant impact of current assets on the profitability position of ITC Ltd from the year 2014-15 to 2018-19.

Interpretation of t-test

$t = -4.36,\ t_{0.05} = 2.132\ \ \&\ t > t_{0.05}$

When the degree of freedom is 3 & the level of significance is 5% the critical value is 2.132. Since the calculated value of t is 4.36 which is more than the critical value we conclude that null hypothesis is rejected which means that there is significant impact of current assets on the profitability position of ITC LTD from the year 2014-15 to 2018-19.

Alternative hypothesis

$\mathbf{H_1}$ There is no significant impact of current assets on the profitability position of ITC Ltd from the year 2014-15 to 2018-19. Since the calculated value of t is 4.36 which is more than the critical value we conclude that there is significant impact of current assets on the profitability position of ITC Ltd from the year 2014-15 to 2018-19.

FINDINGS & SUGGESTIONS

- The short term solvency position of ITC Ltd is favourable and the organisation can easily pay its current liabilities
- The quick ratio of the organisation is reflecting favourable position during the study period.
- It was found that the cost of production of ITC Ltd was slightly high as the gross profit ratio is reflecting downward trend hence the corporation should cut down its cost of production.
- The working capital ratio is reflecting a downward trend which means the corporation has not utilised its working capital.
- Even if the turnover was reflecting downward trend in the last two years but the profitability position was satisfactory during the last two years.

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