WORKING CAPITAL MANAGEMENT OF INDIAN TOOLS LTD WITH SPECIAL REFERENCE TO TOOL INDUSTRY.

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ABSTRACT

The paper explains the importance of liquidity in overall management of financial activities of Indian tools ltd and the analysis of working capital management is done and the liquidity position of the Indian tools ltd is analyzed by using techniques of fundamental analysis and on the basis of which conclusions are drawn.

Keywords: Working capital management, Liquidity, Profitability

Introduction:

The general state of liquidity in corporate sector in recent past particularly after the sharp decline in the interest rates has tended to be reasonably good in India. However, many companies both in public and private sector irrespective of their size, age or product range have been experiencing difficulties in meeting their short-term maturing liabilities. Liquidity and profitability are two important and vital aspects of corporate business life. No firm can survive without liquidity. A firm not making profit may be considered as sick but, one having no liquidity may soon meet its downfall and ultimately die. As a matter of fact, liquidity is a pre-requisite for the very survival of a business firm. Liquidity management has thus, 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 operations. The liquidity should be neither excessive nor inadequate. Excessive liquidity indicates accumulation of idle funds which do not earn any profit for the firm 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. Thus, the need for efficient liquidity management in corporate business life has always been significant for smooth running of the business. In this paper an attempt has been made to analyze the short term management of funds in Zenith-Birla Group, Indian Tools Ltd which is one of the largest and important private sector tool manufacturing Company of India the study is for the period 2000-01 to 2007-08 i.e,eight years is taken to analyze the overall liquidity by comparing data from boom 2000 period to recession 2008 period   . the reason for analyzing Indian tools ltd is tool industry in India is suffering from shortage of short-term finance and hence unable to preserve liquidity which ultimately effects the profitability considering the importance of the issue   Such an analysis is made and which is expected to show and highlight the strengths and weaknesses regarding various aspects of working capital management.

Objectives of the research:

Following are fundamental objectives of the study:
   a. To assess the significance of working capital by selecting few important parameters such as, current ratio, acid test ratio, absolute liquidity ratio, inventory turnover ratio, debtors turnover ratio
   b. To make analysis of the various elements of working capital.
   c. To find out how shortage or excess of working capital affects firms commercial operations
   d. To assess short-term liquidity and solvency of firm.
   e. To prescribe remedial measures to encounter the problems faced by the firm.

Research methodology:

The study is based on secondary data i.e. annual reports/published accounts as well as primary data/ information obtained through personal interview and discussion with managers of the corporate. the period of study is nine years w.e.f 2000-01 and traditional method of data analysis tools and techniques for examining the degree of efficiency of working capital management has been adopted in systematic order. We show component wise gross working capital analysis in exhibit I and working capital ratio analysis in exhibit II .exhibit III will show liquidity position of Indian tool ltd.

Components of gross working capital:

An element wise analysis of gross working capital makes analysis of working capital funds locked up and to find out the factors responsible for the significant changes in working capital of different years .Table I shows the percentage share of various elements gross working capital. Out of the four element of

working capital the element namely inventories contributed highest in gross working capital with an average of 43% and it ranges from 27% to 58% between 2000 to 2008 .From this circumstance, we may infer that the firm is badly constrained to smoothly run the day-to-day commercial operation. It may not be out of place to state that the company simply cannot afford to hold 27.44 to 58.33% of gross working capital when it is having negative working capital. But the positive sign is the decrease of inventory in total current assets for last two years which can be considered as good liquidity position from working capital point of view. The other current asset contributes the second highest portion 50.09% to 13.89% between 2000 to 2008 with average of 26.84% towards the gross working capital. The debtors contributed the third highest in gross working capital from 16.86% to 31.03% between 2000 to 2008 with average of 23.29% which shows that working capital blocked up to increase in debtors resulting collection charges and bad debts are increase first six years. Where as the share of cash and bank in gross working capital increased from 2.97% to 15.51% between 2000 to 2008. This is good because in a comfortable financed business, cash and bank will probably run not less than 5 to 10% of the current assets.

Current Ratio (CR):

This ratio shows the relationship between current assets and current liabilities of a company. It is an important measure of analyzing the firm's ability to payoff its current obligations out of its short-term resources. 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. This assumption is based on the standard ratio 2:1 that in the worse situation even if the possibility of 50% shrinkage in the value of current assets, the firm will be in position to payoff its current obligations. This rule, however, can not be treated as a general guide applicable to all types of businesses. Each firm should develop its own Standard for CR from past experience.

Table II shows that the CR in Indian Tools Ltd registered a fluctuating trend during the period under study. It varied between 0.75 in 2002 and 2.15 in the year 2007. On an average, the CR in Indian Tools was 1.85 during the period under study. The CR of the company in the last two years of the study was far over the conventional norm of 2:1.but for most of the years it was not up to the mark It indicates that the liquidity position of the company was not satisfactory. However, no definite inference can be drawn on the basis of this ratio about the liquidity position of the company as CR considers the quantity of current assets only but fails to consider their quality. Thus, it needs a further analysis of quality of short-term assets.

Quick Ratio (QR):

This ratio is yet another widely used parameter of judging the short-term repaying ability of a firm in the near future. This ratio a refinement over CR as it considers the quality of current assets. This ratio excludes inventories, which is considered slow moving assets in relation to other current assets, thus it can assess the liquidity position of a company more effectively. The rule of thumb about QR is1:1. It is evident from table 1 that the QR also marked a fluctuating trend during the period under study and ranged between 0.71 in the year 2005-06 and 1.56 in the year 2007-08. On an average the QR in Indian Tools was 0.34 during the period of study. The QR in Indian tools was under the conventional norm of 1: 1 throughout the period of study. It clearly indicates that the liquidity position of the company was not satisfactory.

Cash Position Ratio (CPR):

This ratio is also known as Super Quick Ratio. This is still a more rigorous test of liquidity position of a concern. Absolute liquid assets (cash in hand, cash at 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 policy. Table 1 depicts that CPR in Indian Tools Ltd showed a fluctuating trend during the period under study. It ranged between 0.02 in the year 2001 and 0.33 in the year 2007. On an average, this ratio was 0.08 during the period of study. This ratio was less than the average ratio in four years out of total nine years of study and in remaining five years it was greater than or equal to the average of this ratio. This indicates that the liquidity position of the company in most of the years was not good enough to meet its obligations in time. However, to draw any conclusion in this regard the credit facilities granted by the banks to the company should be taken care of.

Inventory Turnover Ratio (ITR):

This ratio focuses 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 higher efficiency of the management and vice versa. It is evident from Table1 that the ITR registered a fluctuating trend during the period under study in Indian Tools Ltd. It varied between 3.11 in the year 2000 and 9.25 in the year 2004- 05. The average of this ratio was 5.14 during the period under study. It can also be observed from table1 that this ratio started improving after reaching at the lowest (3.11) in the year 2000 and reached at the second highest during the last year i.e. 2000. It is thus, clear that the management tried to control its inventory levels to a great extent during the later period of the study. As per the study conducted by CMIE, average ITR of Indian Manufacturing Companies was 2.12 (CMIE, 1998, P.7). The average of ITR in Indian Tools Ltd was higher than the standard set by the CMIE. It is thus; clear that in general the inventory management of Indian Tools Ltd was satisfactory during the period under study .

Debtors 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 management of a company. The liquidity position of a company depends on the quality of debtors to a great extent. It measures the rapidity or the slowness of their collectibility. The high DTR implies the prompt payments made by debtors and vice versa. According to the study conducted by CMIE, average DTR of 11 is considered to be satisfactory in an Indian manufacturing company (CMIE, 1998, P.7). It can be seen from Table 1 that the DTR also recorded a fluctuating trend during the period under study in Indian Tools Ltd. It was highest in the year 2003 and lowest in the year 2006. On an average, the DTR in Indian Tools Ltd was 9.47 during the period under study. The DTR in Indian Tools Ltd was much lower than the standard set by the CMIE in most of the years under study. It signifies slackness of collection efforts and inefficient credit policy followed by the company.

Important Suggestions and conclusions of the study:

1. Should always try to maintain an adequate quantum of net current assets in relation of current liabilities as to keep a good amount of liquidity throughout the year.
2. The company must increase its level of quick assets in relation to current liabilities which will also increase the ratio of net working capital to current liabilities.
3. The company must maintain a reasonable level of absolute liquid assets in order to meet short-term commitments and emergency requirements. This will also help the company in increasing its working capital margin. The company may also make adequate arrangement of credit facilities with banks as to maintain good amount of liquidity at its end.
4. The inventory of slow moving items should be reduced to the maximum possible extent.

Suitable format presenting the level of different components of inventory at fixed time internal be introduced to exercise an effective control on the overall inventories maintained by Indian tools ltd

5. The company should tighten the debt collection efforts and should reduce the amount tied up in debtors. In order to improve the quality of debtors and also to bring down the amount tied-up in debtors, a periodical report of the over dues may be prepared and effective action may be taken by the management time to time to expedite the collections.

6. The overall state of working capital should be improved as to put a favorable impact on the Profitability

7. The management of Indian tools ltd should also try to maintain a definite proportion among various components of working capital in relation to overall current assets to keep an adequate quantum of working capital at all times. Such proportion can be worked out on the basis of past experience by the management of Indian tools ltd. The management is finally advised to follow the principles of "THREE ''Es" to manage , solvency, Profitability, survival and growth of the business.
Following are the messages of "THREE Es":

(i) E1 stands for Economy i. e. at what minimum cost it can produce the goods.

(ii) E2 stands for Efficiency i. e. to do the thing right and finally.

(iii) E3 represents Effectiveness i.e. to do the right thing only. Working Capital Management should not be treated as an isolated management function but it is the part and parcel of overall corporate management functions and impact of corporate management policy and strategy effects working capital management practice of the firm. It is thus necessary to work out and analyze cause-effect relationship of every function of the management to assess its impact on the working capital management.

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Table:I Component of working capital with respective percentage of Indian tools ltd

	Cash to gross working capital	Debtors to gross working capital	Inventories to gross working capital	Others to gross working capital	Gross working capital
2000	578(5.8%)	2169(21.92%)	5772(58.33%)	1375(13.89%)	9894
2001	368(2.9%)	3836(31.03%)	5536(44.78%)	2620(21.19%)	12360
2002	773(6.08%)	2573(20.24%)	5933(46.69%)	3428(26.97%)	12707
2003	838(6.59%)	2856(22.46%)	6411(50.43%)	2606(20.50%)	12711
2005	770(5.24%)	3980(27.12%)	5837(39.78%)	4085(27.84%)	14672
2006	1257(6.97%)	5253(29.16%)	8972(49.81%)	2528(14.03%)	18010
2007	5632(15.51%)	6121(16.86%)	9963(27.44%)	14583(40.%)	6299
2008	18404(4.90%)	6563(17.50%)	10311(27.49%)	18785(50.09%	37499
AVG	6.76%	23.29%	43.09%	26.84%	
MAX	15.51%	31.03%	58.33%	50.09%	
MIN	2.97%	16.86%	27.44%	13.89%	

Table:II Selected liquidity ratios of Indian Tools Ltd.(from2000 to 2008)

	C.R	LTR	A L R	DTR	ITR
2000	0.83	0.34	0.04	8.28	3.11
2001	0.81	0.44	0.02	6.22	4.31
2002	0.75	0.4	0.04	12.65	5.48
2003	0.76	0.37	0.05	14.78	6.58
2004-05	0.77	0.46	0.04	13.58	9.25
2006	1.22	0.61	0.08	5.93	3.47
2007	2.15	1.56	0.33	6.52	4.01
2008	2.09	1.52	0.11	7.83	4.98
AVG	1.17	0.71	0.08	9.47	5.14
MAX	2.15	1.56	0.33	14.78	9.25

MIN	0.75	0.34	0.02	5.93	3.11

Table: III Liquidity position of Indian Tools Ltd.(from 2000to2008)

	C.A	C.L	NWC
2000	9894	11803	-1909
2001	12360	15206	-2846
2002	12707	16838	-4131
2003	12711	16592	-3881
2005	14672	19009	-4337
2006	18010	14750	3260
2007	36299	16858	19441
2008	37489	17853	19636