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A STUDY ON WORKING CAPITAL MANAGEMENT OF AMALGAMATIONS REPCO LIMITED, CHENNAI

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Abstract: Working Capital Management is a continuous essential process of every organization which ensures operations and thereby profits of the organization. Working Capital Management involves Accounts Receivable Management, Accounts Payable Management, Inventory Management and Cash Management.

This study is aimed at evaluating the Working Capital Management practices - Accounts Receivable Management, Accounts Payable Management, Inventory Management and Cash Management and thereby identifying the weaker practice in order to improve on it. Ratio analysis is used on the secondary data obtained from the company records for analysis. The effectiveness of Working Capital Management and the impact of Working Capital on profit is also determined.

It is found that the practices such as Accounts Receivable Management, Accounts Payable Management are improving over the years and also Cash Management is good, but the Inventory Management is found to be getting weaker over the years. It is also found that the Working Capital Management is not very effective and there is a lot of scope on its improvement.

Measures can be taken to reduce the production time and increase sales of the products for better inventory management. The accounts receivable management can be still improved by speeding up the collection process by lock-box system, etc. Negotiations with the suppliers can be done for discounts on prompt payments and thereby enhance the accounts payable management. Measures can be taken to decrease the current assets like receivables by factoring and to increase the fixed assets for better working capital leverage and also better profit. Profitability of the organization can be increased by reducing the working capital requirements and thereby investing the reduced amount in investments with ROI are some of the suggestions proposed based on this study to improve on WCM of Amalgamations Repco Ltd.

Keywords: Amalgamation, Working Capital, Accounts Receivable, Asset, Liability

INTRODUCTION

Working Capital Management policies have a great effect on firm's profitability & liquidity. A finance manager, therefore, chalks out working capital management policies in respect of each of the components of working capital so as to ensure high profitability and liquidity and sound structural health of the organization.

Working Capital management is the management of assets that are current in nature. Current assets, by accounting definition are the assets normally converted in to cash in a

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period of one year. Hence working capital management can be considered as the management of cash, market securities receivable, inventories and current liabilities. In fact, the management of current assets is similar to that of fixed assets the sense that is both in cases the firm analyses their effect on its profitability and risk factors, hence they differ on three major aspects:

1. In managing fixed assets, time is an important factor discounting and compounding aspects of time play an important role in capital budgeting and a minor part in the management of current assets.
2. The large holdings of current assets, especially cash, may strengthen the firm's liquidity position, but is bound to reduce profitability of the firm as ideal car yield nothing.
3. The level of fixed assets as well as current assets depends upon the expected sales, but it is only current assets that add fluctuation in the short run to a business.

Management of working capital is very much important for the success of the business. It has been emphasized that a business should maintain sound working capital position and also that there should not be an excessive level of investment in the working capital components. As pointed out by Ralph Kennedy and Stewart MC Muller, "the inadequacy or mis-management of working capital is one of a few leading causes of business failure.

To understand working capital better we should have basic knowledge about the various aspects of working capital. To start with, there are two concepts of working capital:

- Gross Working Capital
- Net working Capital

Gross Working Capital: Gross working capital, which is also simply known as working capital, refers to the firm's investment in current assets: Another aspect of gross working capital points out the need of arranging funds to finance the current assets. The gross working capital concept focuses attention on two aspects of current assets management, firstly optimum investment in current assets and secondly in financing the current assets. These two aspects will help in remaining away from the two danger points of excessive or inadequate investment in current assets. Whenever a need of working capital funds arises due to increase in level of business activity or for any other reason the arrangement should be made quickly, and similarly if some surpluses are available, they should not be allowed to lie ideal but should be put to some effective use.

Net Working Capital: The term net working capital refers to the difference between the current assets and current liabilities. Net working capital can be positive as well as negative. Positive working capital refers to the situation where current assets exceed current liabilities and negative working capital refers to the situation where current liabilities exceed current assets. The net working capital helps in comparing the liquidity of the same firm over time. For purposes of the working capital management, therefore Working Capital can be said to measure the liquidity of the firm. In other words, the goal of working capital management is to manage the current assets and liabilities in such a way that a acceptable level of net working capital is maintained.

DETERMINANTS OF WORKING CAPITAL

There is no specific method to determine working capital requirement for a business. There are a number of factors affecting the working capital requirement. These factors have different importance in different businesses and at different times. So a thorough analysis of all these factors should be made before trying to estimate the amount of working capital needed. Some of the different factors are mentioned here below:

1. **Nature of business:** Nature of business is an important factor in determining the working capital requirements. There are some businesses which require a very nominal amount to be invested in fixed assets but a large chunk of the total investment is in the form of working capital. There businesses, for example, are of the trading and financing type. There are businesses which require large investment in fixed assets and normal investment in the form of working capital.
2. **Size of business:** It is another important factor in determining the working capital requirements of a business. Size is usually measured in terms of scale of operating cycle. The amount of working capital needed is directly proportional to the scale of operating cycle i.e. the larger the scale of operating cycle the large will be the amount working capital and vice versa.
3. **Business Fluctuations:** Most business experience cyclical and seasonal fluctuations in demand for their goods and services. These fluctuations affect the business with respect to working capital because during the time of boom, due to an increase in business activity the amount of working capital requirement increases and the reverse is true in the case of recession. Financial arrangement for seasonal working capital requirements are to be made in advance.
4. **Production Policy:** As stated above, every business has to cope with different types of fluctuations. Hence it is but obvious that production policy has to be planned well in advance with respect to fluctuation. No two companies can have similar production policy in all respects because it depends upon the circumstances of an individual company.
5. **Firm's Credit Policy:** The credit policy of a firm affects working capital by influencing the level of book debts. The credit term is fairly constant in an industry but individuals also have their role in framing their credit policy. A liberal credit policy will lead to more amount being committed to working capital requirements whereas a stern credit policy may decrease the amount of working capital requirement appreciably but the repercussions of the two are not simple. Hence a firm should always frame a rational credit policy based on the credit worthiness of the customer.

   Availability of Credit: The terms on which a company is able to avail credit from its suppliers of goods and devices credit/also affects the working capital requirement.

If a company in a position to get credit on liberal terms and in a short span of time then it will be in a position to work with less amount of working capital. Hence the amount of working capital needed will depend upon the terms a firm is granted credit by its creditors.

6. **Growth and Expansion activities:** The working capital needs of a firm increases as it grows in term of sale or fixed assets. There is no precise way to determine the relation between the amount of sales and working capital requirement but one thing is sure that an increase in sales never precedes the increase in working capital but it is always the other way round. So in case of growth or expansion the aspect of working capital needs to be planned in advance.
7. **Price Level Changes:** Generally increase in price level makes the commodities dearer. Hence with increase in price level the working capital requirements also increases. The companies which are in a position to alter the price of these commodities in accordance with the price level changes will face fewer problems as compared to others. The changes in price level may not affect all the firms in same way. The reactions of all firms with regards to price level changes will be different from one other.

Need

- Working capital management practices at Amalgamations Repco Ltd. have to be analyzed to improve its performance.
- A research has not been undertaken in it before.

Scope

- Finding the weaker areas of working capital management at Amalgamations Repco Ltd.
- Finding the effectiveness of working capital management of Amalgamations Repco Ltd.
- Finding the impact of Working Capital on profit of Amalgamations Repco Ltd.

RESEARCH METHODOLOGY

Research methodology is a way to systematically solve the research problem. It deals with the objective of a research study, the method of defining the research problem, the type of hypothesis formulated, the type of data collected, method used for data collecting and analyzing the data etc.

RESEARCH DESIGN

Type of Research Design

Descriptive Research

Descriptive studies aims at portraying accurately the characteristics of a particular group or situation. Descriptive research is concerned with describing the characteristics of a particular individual or a group. Hence the descriptive research method is much suitable for this study.

Method of Data Collection

Data are the raw materials of research work. Data collected are classified into two. They are primary data and secondary data.

Secondary Data

Secondary data for this study was collected from the company records and reports.

Evaluation of Working Capital Management practices of Amalgamations Repco Ltd.

Accounts Receivable Management

Debtor Turnover Ratio:

Table 1
Debtor Turnover Ratio over the years

Year	*Net Sales*	*Sundry Debtors*	*Debtor Turnover Ratio*
2008-09	65, 62, 50, 000	17, 94, 45, 173	3.67
2009-10	70, 14, 05, 000	18, 72, 80, 356	3.75

Inference: The debtor turnover ratio is found to be increasing over the years is a good sign of accounts receivable management.

Debt Collection Period

Table 2
Debt Collection Period over the years

Year	*Days in a year (days)*	*Debtors Turnover Ratio*	*Debt Collection Period (days)*
2008-09	365	3.67	100
2009-10	365	3.75	97

Inference: The debt collection period decreasing over the years is a good sign of accounts receivable management.

Accounts Payable Management

Creditor Turnover Ratio

Table 3
Creditor Turnover Ratio over the years

Year	*Purchase*	*Sundry Creditors*	*Creditor Turnover Ratio*
2008-09	44, 80, 69, 815	9, 65, 33, 000	4.64
2009-10	49, 38, 16, 034	12, 00, 00, 000	4.11

Inference: The creditor's turnover ratio is found to be decreasing over the years is a good sign of accounts payable management.

Credit Payment Period

Table 4
Credit Payment Period over the years

Year	*Days in a year (days)*	*Creditors Turnover Ratio*	*Debt Payment Period (days)*
2008-09	365	4.64	79
2009-10	365	4.11	89

Inventory Management

Inventory Turnover Ratio

Table 5
Inventory Turnover Ratio over the years

Year	*Cost of Sales*	*Average Stock*	*Inventory Turnover Ratio*
2008-09	58, 97, 87, 000	1, 02, 34, 000	66.7
2009-10	62, 04, 43, 000	92, 97, 500	57.6

Inference: The inventory ratio is found to be slightly decreasing which is not a good sign of inventory management.

Inventory Turnover Period

Table 6
Inventory Turnover Period over the years

Year	*Days in a year (days)*	*Inventory Turnover Ratio*	*Inventory Turnover Period (days)*
2008-09	365	66.7	5.5
2009-10	365	57.6	6.3

Inference: The inventory turnover period is found to be increasing which is not a good sign of inventory management.

Cash Management

Current Ratio

Table 7
Current Ratio

Year	*Current Asset*	*Current Liabilities*	*Current Ratio*
2005-06	24, 63, 05, 247	12, 97, 35, 726	1.9
2006-07	28, 05, 66, 393	12, 73, 73, 673	2.2
2007-08	28, 90, 37, 593	13, 66, 43, 547	2.1
2008-09	28, 34, 10, 276	12, 87, 85, 036	2.2
2009-10	30, 85, 71, 688	15, 40, 99, 995	2

Inference: The liquidity position of the organization over the years is found to be good.

Quick Ratio

Table 8
Quick Ratio

Year	*Liquid Asset*	*Current Liabilities*	*Acid Test Ratio*
2005-06	16, 16, 74, 305	12, 97, 35, 726	1.3
2006-07	19, 87, 47, 138	12, 73, 73, 673	1.56
2007-08	21, 75, 29, 512	13, 66, 43, 547	1.6
2008-09	20, 82, 02, 242	12, 87, 85, 036	1.6
2009-10	21, 58, 86, 532	15, 40, 99, 995	1.4

Inference: The short term solvency position of the organization over the years is found to be good.

Analysis of effectiveness of Working Capital Management of Amalgamations Repco Ltd.

Working Capital Turnover Ratio

Table 9
Working Capital Turnover Ratio over the years

Year	*Net Sales*	*Net Working Capital*	*Working Capital Turnover Ratio*
2008-09	65, 62, 50, 000	8, 27, 91, 000	7.93
2009-10	70, 14, 05, 000	8, 89, 67, 000	7.88

Inference: The working capital turnover ratio is high and which indicate overtrading and low investment of working capital and more profits.

Working capital leverage

Table 10
Working Capital leverage

CA	*TA*	*% change in CA*	*WCL*
30, 85, 71, 688	43, 12, 63, 026	1	0.72

$$\text{Working capital leverage} = \frac{\text{CA}}{\text{TA} - (\%\ \text{change})\ \text{CA}}$$

Inference: The Company has a WCL which is very sensitive. Even a 1% change in the current asset of the company greatly influences the company's profitability.

Measuring the impact of Working Capital on profit of Amalgamations Repco Ltd.

Table 11
Net profit to Working Capital ratio over the years

Year	*Net Profit*	*Net Working Capital*	*Ratio*
2008-09	38, 71, 000	8, 27, 91, 000	0.47
2009-10	50, 16, 000	8, 89, 67, 000	0.56

Inference: This ratio is found to be increasing over the years. 7% increase in working capital has caused an increase of 30% of profit.

FINDINGS

- The working capital turnover ratio 7.88 is high and which indicate overtrading and low investment of working capital and more profits
- The debtor turnover ratio is found to be increasing from 3.67 to 3.75 and the debt collection period decreasing from 100 to 97 days over the years which is a good sign of accounts receivable management
- The creditor turnover ratio is found to be decreasing from 4.64 to 4.11 and credit payment period increasing from 79 to 89 days over the years. The increase in payment period is good unless it does not affect the credit worthiness of the organization
- The inventory ratio is found to be decreasing from 66.7 to 57.6 and the turnover period increasing from 5.5 to 6.3 days which is not a good sign of inventory management
- The liquidity and solvency position of the organization is found to be good as the current and quick ratios are close to their ideal values
- 7% increase in working capital has caused an increase of 30% of profit
- The Company has a WCL which is very sensitive. Even a 1% change in the current asset of the company influence the companies profitability

SUGGESTIONS

- Measures can be taken to reduce the production time and increase sales of the products for better inventory management
- For an ideal debt collection period of 60 days the sundry debtors should be reduced by 38.4% for the current value of sales or the sales is to be increased by 62.43% for the current value of debtors. It can also be achieved by reducing sundry debtors by 32.98% and increase sales by 8.8% simultaneously
- The accounts receivable management can be still improved by speeding up the collection process by lock-box system, etc.
- Negotiations with the suppliers can be done for discounts on prompt payments and thereby enhance the accounts payable management

- Measures can be taken to decrease the current assets like receivables by factoring
- Increase in fixed assets by 154% can be done for better working capital leverage of 0.5
- Profitability of the organization can be increased by reducing the working capital requirements and thereby investing the reduced amount in investments with ROI

CONCLUSION

Working Capital Management has its direct influence on the profitability of the organization which is very essential and hence it should be done efficiently and effectively. It is a continuous process and hence knowledge management can be done to improve it. The ever changing environment of business makes it difficult to do so, but a continuous monitoring and timely actions can make a great difference.

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