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WORKING CAPITAL MANAGEMENT AND CORPORATE PROFITABILITY IN INDIAN INDUSTRIES - AN EMPIRICAL ANALYSIS

P.Dharmarajan*   V.Abirami**
**Assistant Professor, Department of Commerce with Computer Application,Kaamadhenu Arts and Science College,Sathyamangalam.*
***Assistant Professor in Commerce, P.K.R Arts College for Women, Gobichettipalayam.*

Abstract
Working capital management is important part in company financial management decision. Working Capital refers to a company's Current Assets. Current Assets are Cash and Equivalents, Accounts Receivable, and Inventory. Working Capital Management is applying Investment and Financing Decisions to Current Assets. Working capital management is a very important component of corporate finance because it directly affects the liquidity and profitability of the company. The study investigate the working capital management and corporate profitability of Indian industries by taking a sample of 10 companies for the period of six years from 2005-2006 to 2010-2011. The present study is expected to contribute better to understand companies related factors that shape up the working capital requirements of companies especially in the emerging markets like India.

Key words: Working Capital and Profitability, Cash Equivalents.

Introduction
Working capital is the life blood and nerve centre of a business. Just as circulation of blood is essential in the human body for maintaining life, working capital is very essential to maintain the smooth running of a business. No business can run successfully without an adequate amount of working capital. Working capital refers to that part of firm's capital which is required for financing short term or current assets such as cash, marketable securities, debtors, and inventories. In other words working capital is the amount of funds necessary to cover the cost of operating the enterprises[1].

Meaning
Working capital means the funds available and used for day to day operations of an enterprise. It consists broadly of that portion of assets of a business which are used in or related to its current operations. It refers to funds which are used during an accounting period to generate a current income of a type which is consistent with major performance of the firm existence.

Working capital is that part of company's capital which is used for purchasing raw material and involve in sundry debtors. We all know that current assets are very important for proper working of fixed assets. Suppose, if you have invested your money to purchase machines of company and if you have not any more money to buy raw material, then your machinery will no use for any production without raw material. From this example, you can understand that working capital is very useful for operating any business organization. We can also take one more liquid item of current assets that is cash. If you have not cash in hand, then you cannot pay for different expenses of company and at that time, your many business works may delay for not paying certain expenses. If we define working capital in very simple form, then we can say that working capital is the excess of current assets over current liabilities.

Definition of Working Capital
According to **Genestenberg,**" Circulating capital means current assets of a company that are changed the ordinary course of business from one form to another, as for example, from cash to inventories, inventories to receivables, receivables into cash[2]."
The net working capital of a business is its current assets less its current liabilities.

Current Assets include
- Stock of raw materials
- Work-in-progress
- Finished goods

[1] *www.wikipedia.com*
[2] *Shashi K Gupta, and Sharma, R.,K.,(2008),"Financial Management",Kalyani Publishers,pp.22.1*

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- Trade debtors
- Prepayments
- Cash balances

Current Liabilities include

- Trade creditors
- Accruals
- Taxation payable
- Dividends payable
- Short term loans

Management of Working Capital

A firm must have adequate working capital, i.e.; as much as needed the firm. It should be neither excessive nor inadequate. Both situations are dangerous. Excessive working capital means the firm has idle funds which earn no profits for the firm. Inadequate working capital means the firm does not have sufficient funds for running its operations. It will be interesting to understand the relationship between working capital, risk and return. The basic objective of working capital management is to manage firms current assets and current liabilities in such a way that the satisfactory level of working capital is maintained, neither inadequate nor excessive.

Working capital sometimes is referred to as “circulating capital”. Operating cycle can be said to be the heart of the need for working capital. The flow begins with conversion of cash into raw materials which are, in turn transformed into work-in-progress and then to finished goods. With the sale finished goods turn into accounts receivable, presuming goods are sold as credit. Collection of receivables brings back the cycle to cash.

The company has been effective in carrying working capital cycle with low working capital limits. It may also be observed that the PBT in absolute terms has been increasing as a year to year basis as could be seen from the above table although profit percentage turnover may be lower but in absolute terms it is increasing. In order to further increase profit margins, SSL can increase their margins by extending credit to good customers and also by paying the creditors in advance to get better rates.

Advantages of working capital

- It helps the business concern in maintaining the goodwill.
- It can arrange loans from banks and others on easy and favorable terms.
- It enables a concern to face business crisis in emergencies such as depression.
- It creates an environment of security, confidence, and overall efficiency in a business.
- It helps in maintaining solvency of the business.

Disadvantages of working capital

- Rate of return on investments also fall with the shortage of working capital.
- Excess working capital may result into over all inefficiency in organization.
- Excess working capital means idle funds which earn no profits.
- Inadequate working capital cannot pay its short term liabilities in time.

Objectives of the Study

The major objective of this study are to examine and evaluates the relationship between working capital management and profitability of selected industries. The specific objectives are as follows:

- To analysis a relationship between working capital management and profitability of the sample companies from five Indian industries.

Methodology

The study is explorative in nature and based on secondary data. The data for the study consist of various financial statements of selected companies listed in the Bombay Stock Exchange (BSE) under Group A. The companies are selected by using stratified sampling technique. Using this sampling technique, the companies are formed into groups called strata based on the industry they belongs to. Initially, it was decided to keep in the sample of all the companies listed in the above group.

Particulars	OPM	A_TURN	GEAR	CA/TA	SK/CA	TD/CA	CL/TA	INV_ DAYS	AR_ DAYS	AP_DAYS	CCC	LN_SALES
ROTA	-0.49	0.001	-0.78	0.46	-0.08	0.03	0.61	-0.43	0.44	0.45	0.44	0.57
OPM		-0.32	0.10	-0.65	-0.11	0.02	-0.75	0.99	-0.39	-0.22	-0.40	-0.69
A_TURN			0.25	0.85	0.11	-0.80	0.66	-0.42	-0.70	-0.75	-0.69	0.78
GEAR				-0.02	-0.38	-0.44	-0.07	0.10	-0.25	-0.27	-0.25	-0.11
CA/TA					-0.06	-0.70	0.95	-0.69	-0.25	-0.32	-0.25	-0.99
SK/CA						0.47	-0.25	-0.24	-0.33	-0.45	-0.33	-0.09
TD/CA							-0.60	0.05	0.55	0.50	0.54	-0.64
CL/TA								-0.74	0.06	-0.01	0.06	0.98
INV_DAYS									-0.25	-0.07	-0.25	-0.72
AR_DAYS										0.98	0.99	-0.14
AP_DAYS											0.98	-0.21
CCC												-0.13
LN_SALES												

However, on the further scrutiny it was found that only some companies have the data for the entire study period, while the others not. The inclusions of companies, which possess data for heterogeneous period of time undoubtedly, will disort the method of study. Hence, they have been excluded. In total, 10 companies are finally selected across Automobile (2), Cement (2), FMCG (2), Petroleum (2) and Telecom (2). The period of study is for six years from 2005-2006 to 2010-2011. The data has been collected from the official websites of selected sample companies.

Table 1: Pearson Correlation Coefficients for All Variables Tested for All Companies over the Six Year Period.
Source: Secondary Data

Conclusion

Working capital management is important part in company financial management decision. The ability of the company to continuously operate in longer period is depends on how they deal with investment in working capital management. The purpose of this study is to investigate the relationship between working capital management and corporate profitability. Cash conversion cycle is used as comprehensive measure of working capital management as it shows the time lag between expenditure for the purchase of raw materials and collection of sales of finished goods. The longer the cycle, the larger funds blocked in working capital. Amongst various measures of profitability return on total asset is a better one since it relates the profitability of the business to the asset base. Results of this study found that cash conversion cycle are significantly and positively associated to the return on total assets. Thus, the companies maintain this level of strength for efficient ways of working capital which will ultimately increase companies profitability.

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3. www.google.com
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