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Analysis of Working Capital: A Case Study of Godrej Agrovet Limited

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Abstract

"Working capital is the life blood and controlling nerve centre of a business". No business can be successfully run without an adequate amount of working capital. To avoid the shortage of working capital at once, an estimate of working capital requirements should be made in advance so that arrangements can be made to procure adequate working capital. But estimation of working capital requirement is not an easy task and a large no. of factors have to be considered before starting this exercise. In this paper, authors attempt to highlight the need for working capital and to understand the concept of working capital and its importance. Author also focused on to determine the amount of the working capital employed by GAVL and analyze the working capital management financial performance. Author also offer suggestions based on findings of the study. The present study is restricted to a single unit of GAVL at Khanna.

Keywords: *Working Capital Management, GAVL, CAPM, Working Capital Requirement.*

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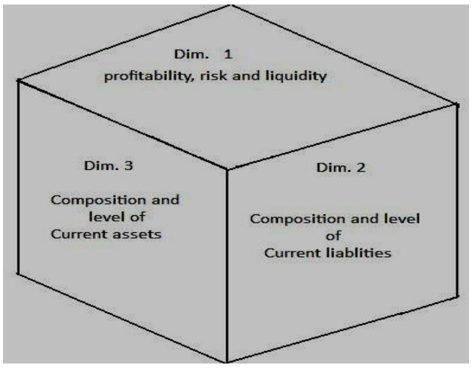
1. INTRODUCTION

Management of working capital refers to all aspects of administration of Working capital, in general practice, it refers to the excess of current assets over current liabilities. The basic goal of working capital management is to manage the current assets and current liabilities of a firm in such a way that a satisfactory level of working capital is maintained, i.e. it is neither inadequate nor excess. This is so because both inadequate as well as excessive working capital positions are bad for any business. Inadequacy of working capital may lead to the firm to insolvency and excessive working capital implies ideal funds which earn no profits for the business. Working capital management policies of a firm have a great effect on its profitability, liquidity and structural health of the organization. In this context, working capital management is three dimensional in nature:

1. Dimension 1st is connected with the formulation of policies with regard to the profitability, risk and liquidity.
2. Dimension 2nd is connected with the decisions about the composition and level of current assets.
3. Dimension 3rd is connected with the decisions about the composition and level of current liabilities



2. REVIEW OF LITERATURE

Studies have been undertaken on Working Capital Management adopting a new approach towards working capital management are reviewed here. **Sagan** in his paper (**1955**), perhaps the first theoretical paper on the theory of working capital management, emphasized the need for management of working capital accounts and warned that it could vitally affect the health of the company. He realized the need to build up a theory of working capital management. He discussed mainly the role and functions of money manager inefficient working capital management. Sagan pointed out the money manager's operations were primarily in the area of cash flows generated in the course of business transactions.

Realising the dearth of pertinent literature on working capital management, **Walker** in his study (**1964**) made a pioneering effort to develop a theory of working capital management by empirically testing, though partially, three propositions based on risk-return trade-off of working capital management. Walker studied the effect of the change in the level of working capital on the rate of return in nine industries for the year 1961 and found the relationship between the level of working capital and the rate of return to be negative.

Weston and Brigham (1972) further extended the second proposition suggested by Walker by dividing debt into long-term debt and short-term debt. They suggested that short-term debt should be used in place of long-term debt whenever their use would lower the average cost of capital to the firm.

Vanhorne in his study (**1969**), recognizing working capital management as an area largely lacking in theoretical perspective, attempted to develop a framework in terms of probabilistic cash budget for evaluating decisions concerning the level of liquid assets and the maturity composition of debt involving risk-return trade-off.

Welter, in his study (**1970**), stated that working capital originated because of the global delay between the moment expenditure for purchase of raw material was made and the moment when payment were received for the sale of finished product.

Lambrix and Singhvi (1979) adopting the working capital cycle approach to the working capital management, also suggested that investment in working capital could be optimized and cash flows could be improved by reducing the time frame of the physical flow from receipt of raw material to shipment of finished goods, i.e. inventory management, and by improving the terms on which firm sells goods as well as receipt of cash.

Cohn and Pringle in their study (**1973**) illustrated the extension of Capital Asset Pricing Model (CAPM) for working capital management decisions. They tried to interrelate long-term investment and financing decisions and working capital management decisions through CAPM.

The first, small but fine piece of work is the study conducted by **National Council of Applied Economic Research (NCAER) in 1966** with reference to working capital management in three industries namely cement, fertilizer and sugar. This was the first study on nature and norms of working capital management in countries with 'scarcity of investible resources'. This study was mainly devoted to the ratio analysis of composition, utilization and financing of working capital for the period 1959 to 1963.

Appavadhanulu (**1971**) recognizing the lack of attention being given to investment in working capital, analysed working capital management by examining the impact of method of production on investment in working capital.

Chakraborty (**1973**) approached working capital as a segment of capital employed rather than a mere cover for creditors. He emphasized that working capital is the fund to pay all the operating expenses of running a business.

Misra (**1975**) studied the problems of working capital with special reference to six selected public sector undertakings in India over the period 1960-61 to 1967-68. Analysis of financial ratios and responses to a questionnaire revealed somewhat the same results as those of NCAER study with respect to composition and utilization of working capital.

Kamta Prasad Singh, Anil Kumar Sinha and Subas Chandra Singh (**1986**) examined various aspects of working capital management in fertilizer industry in India during the period 1978-79 to 1982-93. On the basis of ratio-analysis and responses to a questionnaire, study revealed that inefficient management of working capital was to a great extent responsible for the losses incurred by the FCI and its daughter units, as turnover of its current assets had been low.

N.C. Gupta study (**1987**) examined the determinants of total inventory investment in aluminum and non-ferrous semi firms in private sector. The data had been taken from Stock Exchange, Official Directory, Mumbai for 9 years 1966-67 to 1974-75.

Tewolde (**2002**) claimed that there is also a far reaching effect on the management when firms are strictly regulated and owned by the government. If government owns business firms, the benefits and costs of WCM might be considered to be of a lesser importance because taxpayer's money can be used to pay for their losses. The importance of managing WC is magnified when it refers to firms in developing economies.

Sathyamoorthi and Wally-Dima (**2008**) analysed the working capital management of retail domestic companies that are listed on Botswana stock exchange. The research findings reveal that the listed companies adopted a conservative approach in the management of their working capital and suggest that the working capital is not static overtime but varies with the changes in the state of economy.

Pradeep (**2008**) attempted to analyse the size and composition of working capital. It also tries to examine as to what proportion of current assets has been financed by long-term sources. The study tries to evaluate the effect of size of inventory and impact of working capital through inventory ratios, working capital ratios, and trends, computation of inventory and working capital, and liquidity ranking. It was found that the size of inventory directly affects working capital and its management. Size of inventory and working capital management of Indian Farmers and Fertilizer Cooperative Limited is properly managed and controlled as compared to National Fertilizers Ltd (NFL).

This, analysis of working capital with special reference to Godrej Agrovet Ltd. Is the gap of research, therefore, the paper is based on this gap of research.

3. Need of Working Capital

Every business needs some amount of working capital. The need for working capital arises due to the time gap between production and realisation of cash from sales. There is an operating cycle involved in the sales and realisation of cash. There are time gaps in purchase of raw materials and production, production and sales, and sales and realisation of cash. Thus, working capital is needed for the following purposes:

1. For the purchase of raw materials, components and spares
2. To pay wages and salaries
3. To incur day to day expenses and overhead cost such as fuel, power and office expenses, etc.
4. To meet the selling cost as packing, advertising, etc.
5. To provide credit facilities to the customers.
6. To maintain the inventories of raw material, work in progress, stores and spares and finished stock.

4. Objectives of the Study

1. To understand the concept of working capital and its importance.
2. To determine the amount of the working capital employed by GAVL.
3. To analyze the working capital management and financial performance of the GAVL.
4. To offer suggestions based on findings of the study.

5. Scope Of The Study

The present study is restricted to a single unit Godrej Agrovet Limited (GAVL) at Khanna.

6. Data Collection

To achieve the aforesaid objectives, data is gathered from secondary sources, like annual reports, journals, and related other research papers.

7. Data Analysis

The collected data has been analysed through ratio analysis and only important tables have been presented for data discussion as per research need and which have also taken for data analysis. The effect of working capital policies on profitability of a firm is illustrated in Table 1.

Table 1: Working Capital Policies and Profitability

Particulars	Conservative Policy	Aggressive Policy
Sales	Rs. 324000.07	Rs. 285253.73
Earnings (EBIT)	Rs. 19720.32	Rs. 14092.88
Fixed Assets	Rs. 59530.71	Rs. 43744.45
Current Assets	Rs. 77751.93	Rs. 57994.70
Total Assets	Rs. 137282.64	Rs. 101739.15
Profitability = EBIT		
Total Assets	14.36%	13.85%

Source: Annual reports of GAVL, 2013, 2014

8. Analysis and Interpretation of Data

Table 2: Computation of Gross Working Capital

Particulars	Current year	Previous year
Inventories	32345.32	27500.12
Sundry Debtors	21917.12	17418.54
Cash and Bank	11347.87	2137.12
Other Current Assets	1073.86	398.03
Loans and Advances	11067.76	10540.89
Gross working Capital	77751.93	57994.70

Source: Annual reports of GAVL, 2013, 2014

Table 2 indicates Gross working capital is the capital invested in total current assets of the enterprise. It helps the company to know the current amount of working capital required at right time. As regarding GAVL the overall gross working capital position of the company. In previous year Gross Working Capital was 57994.70 which was increase to 77751.93 in current year.

Table 3: Computation of Net Working Capital

Particulars	Current year	Previous year
Gross working Capital	77751.93	57994.70
Less		
Liabilities	(-)81329.27	(-)64541.8
Provisions	(-)4308.40	(-)2967.91
NET WORKING CAPITAL	(7885.74)	(9515.01)

Source: Annual reports of GAVL, 2013, 2014

Table 3 shows that net working capital is the excess of current liabilities over current asset. In the year 2013-14, Net Working Capital was -7885.74 and in previous year it was (9515.01).

Table 4: Statement of change in Working Capital of GAVL for the year 2013-14

Particulars	**Balance as on 31st April 2014 (000)**	**Balance as on 31st March 2013 (000)**	**Effect on Working Capital**	
			Increase (000)	**Decrease (000)**
CURRENT ASSETS				
Inventories	32345.35	27500.12	4845.23	
Sundry Debtors	21917.12	17418.54	4498.58	
Cash & Bank Bal.	11347.87	2137.12	9210.75	
Other Current Assets	1073.86	398.03	675.83	
Loans & Advances	11067.76	10540.89	526.87	
Total Current Assets	77751.93	57994.7		
CRRENT LIABILITIES				
Liabilities	81329.27	64541.8		16787.47
Provisions	4308.40	2967.91		1340.49
Total Current Liabilities	85637.67	67509.71		
Working Capital (CA-CL)	(7885.74)	(9515.01)		
Net decrease in Working Capital	(1629.27)			1629.27
Total	9515.01	9515.01	19757.23	19757.23

Source: Annual reports of GAVL, 2013, 2014

9. CONCLUSION

This study Realization of objectives of working capital management requires defining the relationship among liquidity, profitability and solvency aspect of current assets and current liability, including a thorough consideration of factors such as risk and benefits. Establishing a relationship between working capital and long-term fixed assets and determining the optimum structure of working capital in the overall structure is necessary. This would not only help to exploit the full potential of fixed assets but also provide a solid base to sustain the business. According to annual report current liabilities is over to the current asset and the GAVL company work on negative working capital. The statement of change in working capital of GAVL Company shows negative result.

10. RECOMMENDATIONS AND SUGGESTIONS

The following are the recommendations and suggestions for the efficient working capital management of GODREJ AGROVET LIMITED.

- The inventory turnover has been increasing. It means there are more chances of obsolescence of material in case of fast moving stock. This will have an unfavourable impact on the liquidity as well as the profitability position of the company. The company has to incur high cost of holding material as it carries inventory for a greater period.

- Proper inventory management should be done so that no excessive and inadequate inventory level can be made. Proper techniques of inventory management like ABC Analysis, Proper maximum, minimum re-order inventory level should be maintained in all the units. So that inventory level can be optimized
- The company should try to reduce loans & advances under the current assets. As loans & advances includes advances recoverable in cash or in kind or for the value to be received, security and other deposits, balance in current account with central authorities and advance income tax paid. So company should try to reduce this level and give more stress on cash balance.
- The finished goods conversion period should be reduced more as it may lead to blocking of funds. By giving discounts, quality goods and developing healthy relations with the customers this period can be reduced.
- The company should try to keep sufficient cash balance to meet its day-to-day expenses and to pay out the dues. Moreover, the company should try to adapt various cash management techniques to maintain cash in better way.
- The raw material conversion period should be reduced. The company should keep inventory according to the requirements.

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