



## WORKING CAPITAL MANAGEMENT AND PROFITABILITY: A CASE OF CEMTAC CEMENTS PVT LTD KASHMIR



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### ABSTRACT

*Working Capital Management has its effect on liquidity as well on profitability of the firm. In present paper, we have selected a Case of Cemtac Cements Pvt Ltd Kashmir, we have calculated the effect of different variables of working capital management including the Average collection period, Inventory turnover in days, Average payment period, Cash conversion cycle and Current ratio on the Net operating profitability of Cemtac Cements Pvt Ltd. Frequency percentage and graphical presentation are used for analysis. It means that It appears from the analysis that the amount of inventory to working capital of Cemtac Cements is reasonable considering the nature and size of the business for given period. It is observed that Cemtac Cements Pvt. Ltd. in comparison of provision for income tax has decreased. It is observed that Cemtac Cements Pvt. Ltd. give a longer conversion period to its debtors. We also find that there is a positive relationship between size of the firm and its profitability. The amount of other liabilities of Cemtac Cements is optimal. The inventory position of Cemtac Cements Pvt. Ltd. is significant than the past years.*

**KEYWORDS:** *Working Capital Management, Income Tax, Liquid Assets, Shareholders, Liabilities, Financial Management*

### INTRODUCTION

Working Capital Management is the process of planning and controlling the level and mix of current assets of the firm as well as financing these assets. Specifically, Working Capital Management requires financial managers to decide what quantities of cash, other liquid assets, accounts receivables and inventories the firm will hold at any point of time. Working capital management is a very important component of corporate finance because it directly affects the liquidity and profitability of the company. It deals with current assets and current liabilities. Working capital management is important due to many reasons. For one thing, the current assets of a typical manufacturing firm accounts for over half of its total assets.

For a distribution company, they account for even more. Excessive levels of current assets can easily result in a firm's realizing a substandard return on investment. However firms with too few current assets may incur shortages and difficulties in maintaining smooth operations (Horne and Wachowicz, 2000). Efficient working capital management involves planning and controlling current.

It refers to the firm's investment in the current assets and includes cash, short term securities, debtors, bills receivables and inventories. It is necessary to concentrate on the fact that the investment in the current assets should be neither excessive nor inadequate. WC requirement of a firm keeps changing with the change in the business activity and hence the firm must be in a

position to strike a balance between them. The financial manager should know where to source the funds from, in case the need arise and where to invest in case of excess funds.

It refers to the difference between the current assets and the current liabilities. Current liabilities are those claims of outsiders, which are expected to mature for payment within an accounting year and include creditors, bills payable, bank overdraft and outstanding expenses. When current assets exceed current liabilities it is called Positive WC and when current liabilities exceed current assets it is called Negative WC. The Net WC being the difference between the current assets and current liabilities is a qualitative concept.

Suggests the extent to which the WC needs may be financed by permanent sources of funds

It is a normal practice to maintain a current ratio of 2:1. Also, the quality of current assets is to be considered while determining the current ratio. On the other hand a weak liquidity position poses a threat to the solvency of the company and implies that it is unsafe and unsound. The Net WC concept also covers the question of judicious mix of long term and short-term funds for financing the current assets.

## **NEED FOR WORKING CAPITAL**

The basic objective of financial management is to maximize shareholders wealth. This is possible only when the company earns sufficient profit. The amount of such profit largely depends upon the magnitude of sales. However, sales do not convert into cash instantaneously. There is always a time gap between the sale of goods and receipt of cash. Working capital is required for this period in order to sustain the sales activity.

Working capital Management refers to all aspects of the administration of both current assets and current liabilities. In other words, working capital management is concerned with the problems that arise in attempting to manage the current assets, the current liabilities and the interrelationships that exist between them.

Moreover, different components of working capital are to be properly balanced in such a way that during one complete production or trade cycle the cash should be available for purchase of fresh material and for running the business including operating expenses, after realization of sale proceeds of earlier cycle without any hurdles.

In the absence of such situation, the financial position in respect of the firm's liquidity may not be satisfactory in spite of satisfactory liquidity ratio.

Working capital management policy has a great effect on firm's profitability, liquidity and its structural health. A finance manager should therefore, chalk out appropriate working capital management policies in respect of each of the components of working capital so as to ensure higher profitability, proper liquidity and sound structural health of the organization. In order to achieve this objective the finance manager has to perform basically following functions i) Estimating the amount of working capital. ii) Sources from which these funds have to be raised. The study is an exercise involving estimation of parameters as regard to organizational requirements. Research was designed so as to get the relevant information that can be used for various purposes in the organization.

To analyze this problem statement, we have developed objectives of our research, which will hopefully contribute towards a very important aspect of financial management known as working capital management. It is almost untouched or very little research has been done in this area. This research is focusing on working capital management and its effects on profitability for a Case of Cemtac Cements Pvt Ltd Kashmir.

The main objectives are:

- To understand the planning and management of working capital at Cemtac Cements.
- To measure the inventory position of Cemtac cements .
- To study cash and bank balance of Cemtac cements
- To suggest ways for better management and control of working capital at the concern.

## **2. LITERATURE REVIEW**

Many researchers have studied working capital from different outlooks and in different environments. The following ones were very stimulating and useful for our research: (Eljelly, 2004) elucidated that proficient liquidity management involves planning and controlling current assets and current liabilities in such a manner that removes the risk of inability to meet due short-term obligations and avoids unnecessary investment in these assets. The relation between profitability and liquidity was examined, as measured by current ratio and cash gap (cash conversion cycle) on a sample of joint stock companies in Saudi Arabia using correlation and regression analysis. The study found that the cash exchange cycle was of more importance as a measure of liquidity than the current ratio that affects profitability. The size variable was found to have significant effect on profitability at the industry level. The results were stable and had important implications for liquidity management in various Saudi companies. First, it was clear that there

was a negative relationship between profitability and liquidity pointers such as current ratio and cash gap in the Saudi sample examined. Second, the study also revealed that there was great variation among industries with respect to the significant measure of liquidity. (Deloof, 2003) discussed that most firms had a large amount of cash invested in working capital. It can therefore be expected that the way in which working capital is managed will have a significant influence on viability of those firms. Using correlation and regression tests he found a significant negative relationship between gross operating income and the number of days accounts receivable, inventories and accounts payable of Belgian firms. On basis of these results he suggested that managers could create value for their shareholders by reducing the number of days' accounts receivable and inventories to a reasonable minimum. The negative relationship between accounts payable and profitability is consistent with the view that less profitable firms wait longer to pay their bills. (Ghosh and Maji, 2003) in this paper made an attempt to scrutinize the efficiency of working capital management of the Indian cement companies during 1992 - 1993 to 2001 - 2002. For measuring the efficiency of working capital management, performance, utilization, and overall efficiency indices were calculated instead of using some collective working capital management ratios. Setting industry norms as target-efficiency levels of the individual

firms, this paper also tested the speed of achieving that target level of efficiency by an individual firm during the period of study. Findings of the study indicated that the Indian Cement Industry as a whole did not perform unusually well during this period.

**OBJECTIVES OF THE STUDY**

- ✧ To understand the planning and management of working capital at Cemtac Cements.
- ✧ To measure the inventory position of Cemtac cements.
- ✧ To study cash and bank balance of Cemtac cements.
- ✧ To suggest ways for better management and control of working capital at the concern.

**METHODOLOGY**

Descriptive research design to fulfill my objective.

**Data Source:-**

The data used for analysis was provided by the finance department of Cemtac Cements Pvt. Ltd. Kashmir. Data of firm's Balance sheet of previous year, Profit and Loss A/C, Magazines, Journals etc. The most recent six Months formed the basis of our calculations.

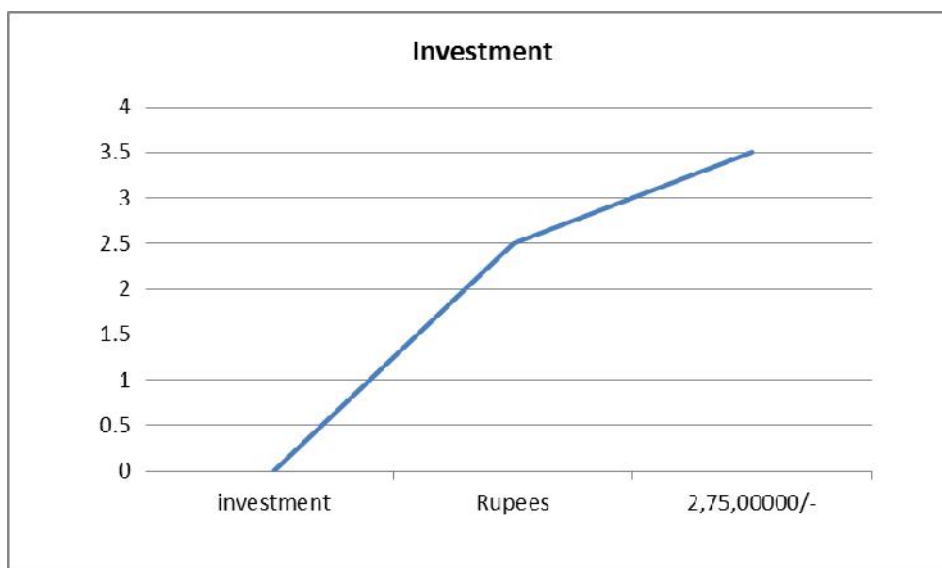
**Data Analysis and interpretation:-**

Simple graphical presentation used for analysis

**Company Age:-**

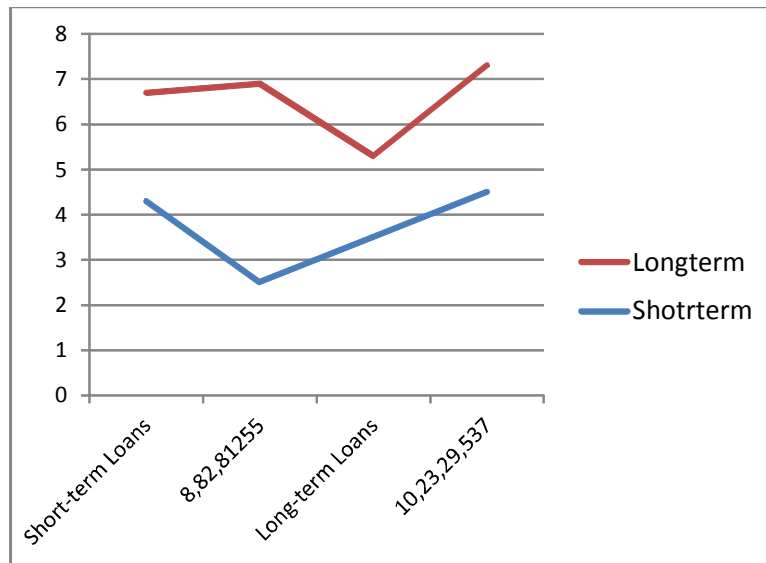
The company was established in 1998 and had been working for 17 years.

**FIG-1, Investment of the Company**



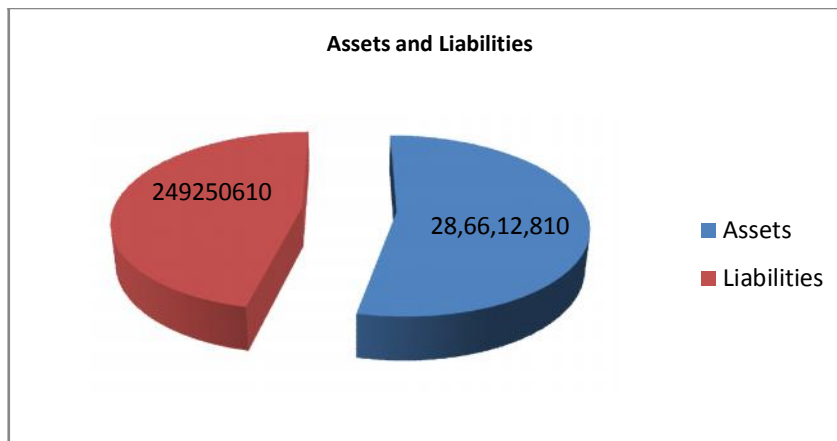
The investment for setting up Cemtac Cements Company was Rs. 2,75,00000/-

**FIG-2, Loans and Borrowings:-**



The company had taken short-term loans worth Rs. 8,82,81255/- and long-term loans worth Rs. 10,23,29,537/- .

**FIG-3, Assets and Liabilities of the company**



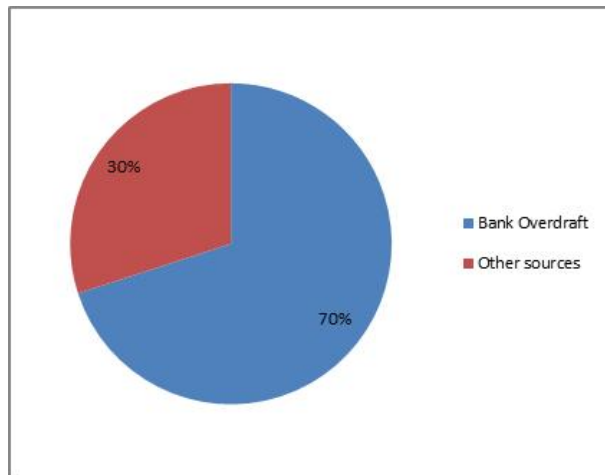
The assets of Cemtac Cements are worth Rs. 286,6,12,810/- and Liabilities are worth Rs. 24,92,50,610/-

**FIG-4, Profitability of the company.**



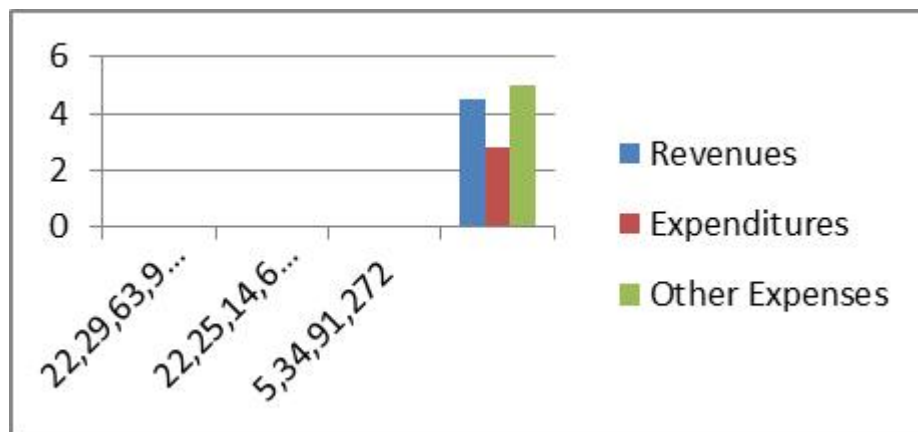
The profitability of Cemtac Cements is Rs. 29,0,639.27/-

**FIG-5, Sources of finance**



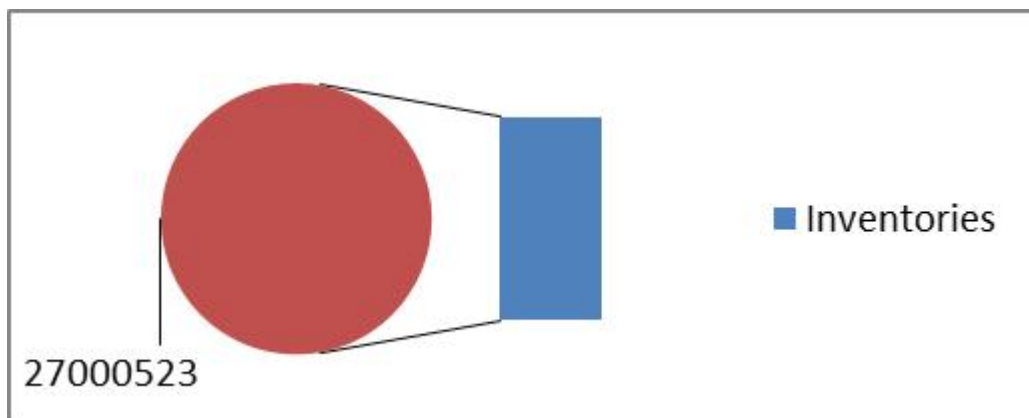
The company sources 30% of its financial needs from other sources while 70% from Bank overdrafts.

**FIG-6, Company revenues and expenditures**

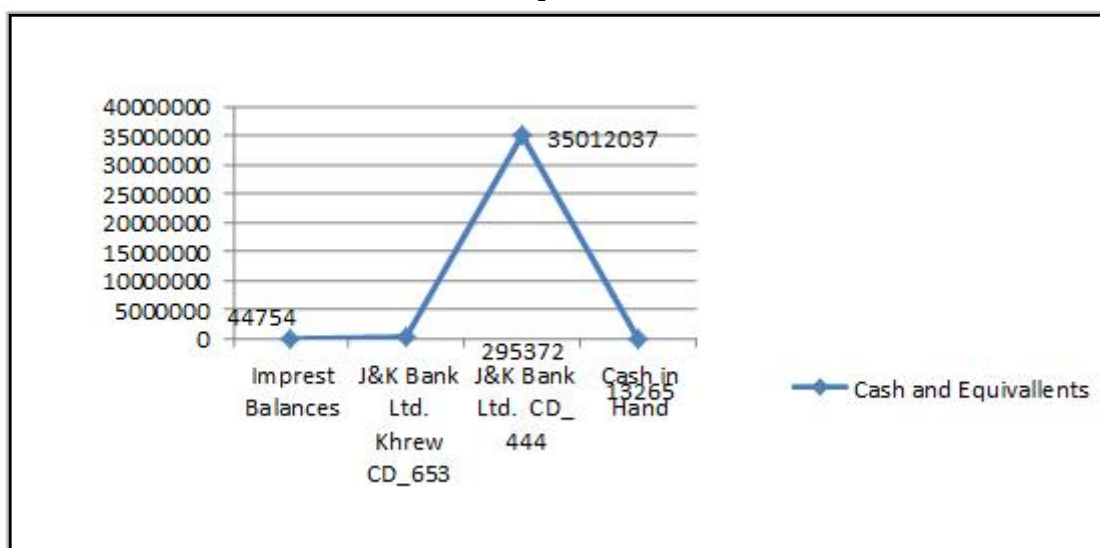


The company had generated its revenues worth Rs. 22,29,63,907/- while having expenditures worth Rs. 22,25,14,670/- and other expenses worth Rs. 5,34,91,272/-

**FIG-7, Inventory position of Cemtac Cements.**



The inventory position of Cemtac Cements is worth Rs. 2, 70, 00,523/-

**FIG-8, Cash and Cash equivalents of Cemtac Cements.**

The company had Impress Balances worth Rs.44, 754/-,J&K Bank Ltd. Khrew CD-653 worth Rs. 2,95,372/-,J&K Bank Ltd. CD-444 worth RS. 3,50,12,037/- and Cash in hand worth Rs. 13,265/- Respectively.

## FINDINGS

On the basis of survey regarding working capital management of Cemtac Cements Pvt. Ltd. Following information found:

- ☆ It appears from the analysis that the amount of inventory to working capital of Cemtac Cements is reasonable considering the nature and size of the business for given period.
- ☆ It is observed that Cemtac Cements Pvt. Ltd. in comparison of provision for income tax has decreased.
- ☆ It is observed that Cemtac Cements Pvt. Ltd. give a longer conversion period to its debtors.
- ☆ The amount of other liabilities of Cemtac Cements is optimal.
- ☆ The inventory position of Cemtac Cements Pvt. Ltd. is significant than the past years.

## SUGGESTIONS

The management of working capital plays a vital role in running of a successful business so, things should go with a proper understanding for managing cash, receivables and inventory.

Cemtac Cements Pvt. Ltd. Is managing its working capital in a good manner, but still there is some scope for improvement in its management. This will ultimately improve the efficiency of its operations. Following are some suggestions to the company in achieving its desired objectives:

The business runs successfully with adequate amount of the working capital but the company should see to it that the cash should not be tied up in excessive

amount of working capital. The over purchasing function should be avoided as it could lead to liquidity problems. Holding of excessive and insufficient stock must be avoided as it creates a burden on the cash resources of a business and results in lost sales, delays for customers, etc. The investment in marketable securities should be used, as it may be profitable for the company.

## LIMITATIONS OF THE STUDY

Only the printed data about the company was available and not the back-end data. It is based on consultation, discussion with the authorized person related to finance. Since some data is of confidential nature so it has not been disclosed. Future plans of the company where not disclosed.

## CONCLUSION

From the survey of working capital management of Cemtac cements pvt.ltd.

That the working capital position of the company is sound and the various sources through which it is funded are optimal. The company has used its purchasing, financing and investment decisions to good effect can be seen from the inferences made earlier in the paper. The company has not compromised on production and profitability. Despite the competition from the various Cement Industries, Cemtac Cements is nevertheless in keeping its neck and crop.

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