CHAPTER VIII

CONCLUSIONS AND SUGGESTIONS

The present study was undertaken to examine various aspects of working capital management. Detailed study of working capital management is warranted by the fact that efficient management of working capital plays crucial role in the successful functioning of a business enterprise. Not only does the working capital facilitate the utilisation of capacities created by fixed capital, it also often accounts for a major portion of total investment in business enterprises. Therefore undertaking an analytical, critical and comprehensive study of different aspects of management of working capital in Indian companies was in order. To achieve this end, the present study attempted to examine tyre companies as a case.

Tyre industry, representing 43 tyre companies are located all over India. Despite large number of companies, 10 large tyre companies account for over 95% turnover of the Indian tyre industry. Among these 10 large companies, four namely Apollo, Ceat, J.K. Industries and MRF contributes more than 70% turnover of tyre industry.

Indian tyre industry is having a turnover of approximately Rs.14,500 crores in the year 2005-06 and it contributes Rs.3,500 crores by way of tax and duties to the Government of India. Indian tyre industry is one of largest contributors of Excise duty (Rs.1,600 crore approx.) to the government of India.

In the wake of growing pressure to meet the challenge of increasing competition, the tyre industry is under stress to utilise its resources efficiently. In this process efficient utilisation of short-term funds of working capital is of
utmost importance. Working capital management is likely to have great impact on the day to day efficiency of the industry with its multiplied synergistic influences down the line.

The study has made detailed analysis of different aspects of working capital i.e. adequacy of working capital, cash management, receivables management, inventory management and financing of working capital of sample tyre companies. In the selection of sample, effort has been made to study those companies who can truely represent the total industry. For that purpose market share has been taken as the basis. The three companies are (i) Apollo Tyres Ltd., (ii) Ceat Ltd. and (iii) MRF Ltd. and these 3 companies command more than 50% market share of tyre industry.

For the purpose of analysis, necessary company level data were collected for the period 1995-96 to 2004-05 from capital Line Data Base Package, CMIE Prowers Database Package and Annual Reports of these companies. For analysis the techniques employed included accounting techniques like ratio analysis and statistical techniques like averages, standard deviation and co-efficient of variation for analysis. Personal interview method was also used for collecting information.

The working capital estimates are based upon detailed estimates of various components of the working capital. There is no single person responsible for the management of working capital. Different departmental heads share this responsibility, say, the head of finance department is responsible for cash management and the head of purchase department is responsible for the management of work-in-process, the head of marketing department is responsible for the finished goods inventory and receivables likewise. Further, there is constant control and supervision of the working
capital by preparing "Working Capital Control Statements" or other statements of the same nature on periodic basis by finance department.

FINDINGS

The important findings of the present study are summarised as under:

The analysis about the growth in the working capital in response to the growth in sales over the 10 years period of study leads to the conclusion that this relationship is positive but inconsistent. As, in some years sales have increased more than the working capital, while in the other the working capital has increased more than the sale. The average change in sales on year to year basis is 9.33% of Apollo, 2.54% of Ceat and 6.72% for MRF. The average change is gross working capital on the year to year basis is 8.65%, 3.96% and 8.76% for Apollo, Ceat and MRF respectively.

Working capital assumes a significant place in total capital structure of a company. Net working capital as a percentage to total capital employed comes out to 33.4% in case of Apollo, 30.2% in Ceat and 49.36% in case of MRF. It implies that MRF maintains about half of its total capital in the net working capital where as the other two companies have relatively smaller share of net working capital in total capital employed.

The working capital structure analysis of the three companies does not reveal similarity. Common feature is that cash and bank balance in all the three companies is small proportion of their total working capital. Inventory has been found to be the most dominant component of working capital for Apollo (32%), followed by Loans and Advances (31.6%). In case of Ceat, Loans and Advances constitute almost half of the working capital (50.12%) followed by Debtors (23.44%), inventory (19.60%) and Cash and Bank
(6.84%). In MRF sizeable portion of working capital is in the form of debtors (42.13%) and inventory (41.65%).

The liquidity analysis of the tyre companies in terms of current assets to fixed assets ratio reveals that current assets as a proportion of fixed assets are greater than one in case of all the 3 companies. It indicates tyre companies place greater emphasis on short term assets than long term assets, which provides reasonable safety margin of safety to the suppliers of fund.

Liquidity and profitability are considered to be competing aspect of working capital. It has been observed that this general belief regarding profitability and liquidity holds true in case of Ceat and MRF where liquidity has gone up over the study period but the profitability has declined. In case of Apollo tyres both liquidity and profitability have declined. Another observation is that coefficient of variation of profitability in all the sample companies is more than the coefficient of variation of liquidity.

The efficiency in the utilisation of working capital has been measured through working capital turnover ratio (Sales/Net Working Capital). It is observed that Apollo tyres is most efficient (5.65 times) followed by MRF (3.79 times) and Ceat (7.80 times) on an average basis over the study period. It has also been observed that working capital turnover ratio of Apollo and Ceat has improved over the study period but has declined for MRF. Hence, MRF needs immediate attention in this regard.

Liquidity of working capital has been studied from two angles: Firstly, in term of inventory as a percentage of gross working capital; and secondly, cash plus receivables as a percentage of gross working capital, the analysis of liquidity of the working capital shows that sample tyre companies keep larger portion of working capital in liquid form (cash and receivables) and smaller
portion in non liquid form (inventory). The performance of these companies in this regard is satisfactory and there is a margin of safety to suppliers of funds. Inventory to gross working capital over the study period is 31.8%, 19.85% and 40.88% for Apollo tyres, Ceat and MRF respectively, on the other hand cash and receivables to gross working capital in the same period is 36.27%, 30.28% and 47.43% for the three companies.

Analysis of adequacy of working capital to pay off current liabilities as and when they become due showed that tyre companies are maintaining adequate working capital. Current ratio of 3 companies is : Apollo – 1.7:1, Ceat – 2.07:1 and MRF – 2.82:1. Quick ratio of these companies is : Apollo – 1.16:1, Ceat – 1.66:1 and MRF – 1.67:1, cash in terms of number of days of current liability and net cash flows to current liability were the other two tests that have been applied to judge adequacy of working capital. It has been found that overall cash holding for meeting the current liability is falling in case of MRF and Ceat but rising in case of Apollo. Net cash flow generation in MRF is much more than Apollo and Ceat.

To analyse the degree of control over cash flows, cash to current assets ratio has been calculated. It has been found to be 11% in Apollo, 7% in Ceat and 6% in MRF. It implies from profitability point of view MRF manages to work with lesser cash as compared to Ceat and Apollo.

To judge the efficiency in the utilisation of available cash by the companies, cash turnover ratio has been calculated. Our finding is that Apollo, Ceat and MRF have been in a position to generate sale equal to 22 times, 22 times and 43 times respectively. Lower cash to current liability ratio indicates better utilisation of cash. The finding is that Ceat and MRF have improved their utilisation of cash but Apollo requires further strengthening of its cash flow system.
About the receivable management, the finding is that no definite trend emerges from the calculations of individual years in the study period. The growth in sale of Apollo is more than growth of receivables but in Ceat and MRF it is other way round, which means these two companies are following more liberal credit policy. This view-point has been strengthened by the fact that average collection period in Ceat - 61 days and MRF - 62 days is more than the average collection period of Apollo tyres - 43 days. Over the study period there is decline in collection period of Apollo tyres. On the other hand, average collection period has increased in Ceat & MRF.

The efficiency in the utilisation of funds invested in receivable has been measured in terms of receivable turnover ratio, which is 10.22 times for Apollo, 6.01 times for Ceat and 5.84 times for MRF. It indicates that like average collection period the performance of Apollo is better than other two companies.

The efficiency in collection of dues has been measured by preparing the ageing schedule. Other result shows that companies are able to restrict more than 6 months old dues. It is 5.97% for Apollo, 4.4% for Ceat and 1.18% for MRF.

Another test for judging the effectiveness of credit policy is how a company controls its bad debts. It has been observed that all the three companies are able to control their bad debts up to a reasonable level. In MRF bad debts are the least – 0.3% of receivables.

The proportion of raw material, stores and spares, semi-finished goods and finished goods in the total inventory varies from company to company. In Apollo tyres raw material is 45% of total inventory followed by 35% finished goods, 11% stores and spares and 9% of semi-finished goods, on the other
hand in Ceat and MRF investment in finished goods is maximum followed by raw material, semi-finished goods and stores and spares.

The efficiency in the management of inventory has been evaluated by calculating various inventory ratios. Inventory turnover ratio is 7 times for Apollo and 8 times for Ceat and 6 times for MRF. There has not been much change in this ratio for Apollo and MRF over the study period but Ceat has improved from 6 times in 1995-96 to 13 times in 2004-05, which shows the company has done more business with proportionately less inventory.

It has been found that Apollo, Ceat & MRF are keeping on an average raw material inventory of 34 days, 25 days and 22 days of cost of sales respectively. Over the study period Apollo & MRF have reduced their holding period but there is a slight increase in holding period of Ceat Ltd. i.e. from 23 days to 25 days. The situation of work in progress turnover rate is also satisfactory. It shows a declining holding period in case of all the three companies. The average work in progress is 4.67 days of cost of sale for Apollo, 5.29 days for Ceat and 8.3 days for MRF.

About the stores and spares companies are maintaining on an average stores of 3 to 6 days which is satisfactory. In case of finished goods our analysis shows that Apollo is having a turnover rate of 19 days, Ceat 25 days and MRF 32 days of cost of sales. This turnover rate has improved over the study period for Apollo and MRF but declined for Ceat.

It has been found that all the three companies are preparing daily, weekly and monthly inventory reports on a regular basis to have effective check on inventory levels. Companies have been found to be preparing inventory turnover analysis but generally on an aggregate basis, and not on individual items of raw material and finished goods.
As regards the financing of working capital, companies have been found to be using moderate approach. The degree of risk in all the three companies is between zero to one. Over the study period risk assumed in financing of working capital has increased in Apollo tyres and Ceat and has fallen in MRF.

While analysing the different short term sources of financing the working capital it has been observed that companies are relying more on external sources as compared to internal sources. With in the external sources, the most important sources of finance are trade credit and bank credit which together finance approximately 50 percent of current assets.

TESTING OF HYPOTHESES

In the light of these findings the hypotheses framed in the beginning have been found as under:

1. Working capital in tyre companies suffers from inadequacy – has been proved wrong.

2. Efficiency in utilisation of investment in total working capital and its components has reduced – tested negative.

3. Moderate approach to financing working capital is used – has been proved true.

4. External finance plays more important role than internal funds in financing of working capital – has been found true.
SUGGESTIONS

It may well said that the progress and prosperity, financial health and stability, of an industrial or business organisation largely depends on the effective management and control of various facets of working capital. Thus, an appropriate application of principles and practices of working capital management may go a long way in achieving the desired results. As the analysis shows, there is lot of scope for further improvement in working capital management of tyre companies in India. Some of the suggestions are:

- There is a need for proper planning of working capital by tyre companies. It is suggested that more thoughtful of periodic cash flow statements along with the income statement and the balance sheet should be made use of.

- Though there is an improvement in the management of various components of working capital by tyre companies, there is still scope to improve it. It is suggested to reduce the portion of loans and advances, specially for Ceat Ltd.

- Cash budget should be prepared, not only for short period as has been the practice, but also for two to three years or even five years. Long term cash budget should better be prepared on “Adjusted net income method” which largely resembles the funds flow statement.

- Companies are advised to get the entire credit balance in current account transferred to company’s cash credit account so as to save the amount of interest payable thereon.

- Surplus cash to the company for a shorter span of time must be invested gainfully, in some safe and sure avenues of short term investment.
As observed, there has been an increase in average collection period. It is suggested to periodically review sundry debtors, based on past performance, and revising the credit rating accordingly.

Ageing analysis of sundry debtors should be done not only period-wise but also customer wise.

A well designed and definite collection plan and programme must be evolved and improve upon, from time to time.

As observed there is a vast scope for bringing improvements in the area of inventory management and control, companies should not only end up in analysing things but also act upon. To illustrate companies should not stop only doing ABC analysis but periodically review it, too, and should take remedial measures.

Companies should develop long term relationship with vendors, so as to ensure strict adherence to the delivery schedules and quality control.

There should be fast disposing of the obsolete items in the inventory.

Last but not the least it is suggested to develop team spirit and the culture of coordination and cooperation among different departments (like material and purchase, production and marketing and above all, the finance deptt). In order to make working capital management effective, introduction of the scheme of reward and punishment to entire team representing different departments, (instead of excellent individual official) may go a long way in developing the requisite team spirit.