CHAPTER I

INTRODUCTION AND RESEARCH METHODOLOGY

INTRODUCTION

Management of financial resources is one of the most important area of overall management. The financial decisions are based upon organisation’s objective of wealth maximisation. Each concern broadly keeps two types of assets with it, namely, long-term assets and short-term assets. Accordingly it employs two types of sources of finance namely long-term sources and short-term sources of finance. Long term assets and long term sources of finance form the subject matter of capital budgeting decisions, whereas short-term assets and short term sources of finance form the subject matter of working capital management. Both capital budgeting and working capital management are equally important wings of overall financial management. However, greater importance has always been attached to the allocation and utilisation of fixed capital. The allocation and effective management of working capital appears to have been relatively neglected.

Working capital is much in use in common parlance and is also most misunderstood. Even among the professional managers the controversy and confusion persist. While an accountant will regard working capital as current assets minus current liabilities and calls it as net working capital, a finance manager will consider gross current assets as working capital. Both may be true, but their concerns differ, the former is concern is arithmetical accuracy, trained as he is to tally the two sides of the balance sheet. But the finance manager’s concern is to find funds for each item of current assets at such costs and risks that the evolving financial structure remains balanced between the two.
Working capital management, which encompasses the short term investment and financing decisions of the firm, affects profitability as well as liquidity of the enterprise. Excessive working capital leads to unremunerative uses of scarce funds, inadequate working capital interrupts the smooth run of business activity and thus both impair profitability.

Effective working capital management, by optimising the use of funds in working capital, enhances profitability. It improves liquidity by focusing attention on flow of funds through proper management of cash, bills receivables, inventories and short-term sources of funds. Importance of efficient working capital management can be judged from the fact that while its effective provision can do much to ensure the success of a business, its inefficient management can lead not only to loss of profits but also to ultimate downfall of what otherwise might be considered as a promising concern.¹

The present study is based on the premise that skilled working capital management and satisfactory provision of working capital can lead not only to material savings in the economical use of capital but can also assist in furthering the ultimate aim of business, namely of maximising financial returns on the minimum amount of capital which need to be employed.

The present work confines the problem of management of working capital of the selected tyre companies in India. The tyre industry is passing through a critical phase. It is a growing industry, functioning under stiff competition. The problem of working capital management of tyre companies is of unique nature for its global network. Further, a significant portion of total capital of tyre companies is in the form of working capital.

IMPORTANCE OF TYRE INDUSTRY

Tyre industry in India is one of the various industries that has gained substantial significance primarily due to the expansion and modernisation of automobile industry. The tyre industry has always occupied a place of major significance because it supplies most essential component to one of the most important infrastructure sector namely transport sector. This industry attracts quite a lot of government attention because of its heightened role in the main infrastructural transport sector.

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 those 10 large companies, four namely Apollo, Ceat, J.K. Industries and MRF contributes more than 70% turnover of tyre industry. Worldwide too, tyre industry is highly concentrated with top three global players accounting for approx. 60% of world tyre industry turnover.

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 new economic scenario in India, tyre industry is passing through a phase of restructuring and change. Merger, Acquisition, Closurer, Job Working, Technical Collaboration, setting up of Greenfield plants by multinational corporations are some of the developments happening at an accelerated pace. Following this period of consolidation and change, Indian
tyre industry will emerge in a better position to take on the challenges of the years ahead.

**IMPORTANCE AND JUSTIFICATION OF THE STUDY**

The importance of the study lies in the fact that the manner of administration of working capital determines to a very large extent the success or failure of overall operations of an enterprise. Many times, in the event of a failure of a business concern, the shortage of working capital is given out as its main cause. But in the ultimate analysis, it may be the mismanagement of resources of the firm that could have converted an otherwise successful business into an unsuccessful one. Proper management of working capital is, therefore, of crucial importance for the success of an enterprise, which involves the management of all current assets.

Tyre industry represents the backbone of the road-transport system. The present day status of this industry shows a huge investment and annual turnover of around Rs. 14,500 crores. The industry provides direct and indirect employment to lakhs of people.

The industry had been experiencing recessionary phase for a long time. However, with the entry of a number of international giants in automobile sector in the country the tyre industry has entered a new phase of evolution. Under the influence of multinationals entering automobile sector and of rising competition there has been increasingly progressive effort by tyre manufactures to upgrade the quality of their products, increase the range of products and manufacture products with international quality standards at competitive prices. In simple words the face of tyre industry in India is undergoing fast change ever since the launch of liberal economic policies since 1991.
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. Therefore, a systematic study of working capital management practices in the industry is called for.

Keeping in view the growing importance of working capital management in tyre industry, the topic entitled “ANALYSIS OF WORKING CAPITAL MANAGEMENT IN INDIA (A CASE STUDY OF SELECTED INDIAN TYRE COMPANIES)” is taken for research study. The researcher feels that the study will draw the interesting results and some useful and constructive suggestions may be provided for overall improvement in working capital management of tyre companies under study.

OBJECTIVE OF THE STUDY

The objective of the present study is to make a detailed analysis of working capital management of selected tyre companies in India. For this purpose the study examines the optimum level of working capital and its adequacy to payoff current liabilities. The study also examines the financing pattern of working capital and make suggestions for the improvement in the working capital management. The study has made detailed analysis of different aspects of working capital.

- Cash management
- Receivables management
- Inventory management
- Financing of working capital
The present study attempts to seek answer to the following questions:

(i) Do the selected tyre companies plan their working capital requirement properly?

(ii) Have these companies utilised the investment in current assets effectively?

(iii) Are cash resources utilised effectively and properly?

(iv) What is the practice followed for collecting accounts receivables.

(v) What is the policy regarding Inventory?

(vi) What is the pattern of financing working. Capital Requirement of these Tyre Companies?

In the present work the effort shall be made to answer above questions for examining working capital management of selected tyre companies.

The ultimate objective of the present work is to make suggestions and recommendations for improvement of working capital management of the said tyre companies.

**HYPOTHESIS**

Following hypotheses are framed with reference to working capital management of selected tyre companies in India.

1. Working capital in tyre companies suffers from inadequacy.

2. Efficiency in utilisation of investment in total working capital and its components has reduced.
3. Moderate approach to financing working capital is used.

4. External finance plays more important role than internal funds in financing of working capital.

RESEARCH METHODOLOGY AND SAMPLE DESIGN

Sample Selection

The present work is based on sample of companies taken from tyre industry working capital is by and large connected with the sales turnover of the company. Fluctuating in the amount of sales have a positive relationship with the quantum of working capital. Hence, the companies to be included in the sample are based upon their sales turnover and relative market share at the time of commencement of this study.

The sample consists of three large tyre companies which commands more than 50% market share of the tyre industry. 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.

Companies that have been selected for the purpose of this study are –

(1) Apollo Tyres Ltd.

(2) Ceat Ltd.

(3) MRF Ltd.

Data Base

The data consist of time series financial statement data comprising current assets, current liabilities, and their components. Besides, data are also to be collected with respect to fixed assets, total assets, total liabilities,
depreciation, profits, cost of raw material consumed, cost of production, cost of sales and sales.

In the present study, a year is taken to mean financial year.

Source of Information

Data have been mainly collected from capital line data base package and CMIE – Prowess Database Package. Information has also been taken from the annual reports of the sample companies, official stock exchange Directory, Mumbai, Corporate Financial Statistics of Reserve Bank of India, Economic Survey, Publications of Automotive Tyre Manufacturing association. Unstructured Personal Interview Method was also used for collecting information about the sample companies.

Tools of Analysis

Tools of analysis employed in this study include the following:

1. Accounting Technique

2. Statistical Technique

Accounting technique includes ratio analysis. Ratio analysis has been regarded as the principal method in analysing, interpreting and comparing the time series accounting data of different firms.¹ To examine the efficiency with which working capital is being managed in the enterprise, management uses the ratio analysis.² Therefore, it has been employed in the present study. The


The purpose of ratio analysis is to analyse the size, composition, efficiency in circulation and financing of working capital. Various ratios computed for analysis have been explained at the relevant places in different chapters.

Statistical techniques, used in this study, include average, standard deviation, coefficient of variation, growth rate, and average growth rate.

Average gives a single value to describe the whole data. Simple arithmetic mean of each series of different ratios has been obtained by adding the values of all observations and dividing it by the number of observations.

Coefficient of variation is a relative measure of dispersion. It relates the standard deviation and the mean by expressing the standard deviation as a percentage of the mean.

Coefficient of Variation = (Standard Deviation / Mean) \times 100

In ratio analysis of financial data, less coefficient of variation in a ratio is taken to mean relatively better control of the management on that ratio.

Growth rate implies the percentage increase in a variable over the previous year figure. Growth rates are computed to find out the rate at which working capital, its components and other variables increase during the study period. Average growth rate has been taken as the arithmetic mean of individual growth rates.

**Period of Study**

10 years data have been taken for the purpose of this study from the year 1995-96 to 2004-2005.
PLAN OF THE STUDY

The study has been divided into eight chapters including the present one. Chapter 1 deals with introduction, importance and justification of the study, objectives, research questions, sample, sources of information, methodology followed, plan of the study, and the limitations. Chapter 2 examines nature and scope of working capital management – conceptual framework and practices relating to working capital management of tyre companies. Chapter 3 gives a profile of tyre industry in India with special reference to sample tyre companies. Chapter 4 examines management of cash – objective of cash management, its determinants, control of cash flows, cash planning by tyre companies and its performance evaluation. Chapter 5 discusses management of receivables with reference to practices and evaluation of receivable management. Chapter 6, management of inventory – highlights inventory management techniques, models and performance evaluation of selected tyre companies. Chapter 7, attempts to examine pattern of financing of working capital and its control and banking policy regarding financing working capital. Finally, chapter 8 - gives conclusions and suggestions, summarises the present study and gives the important findings of the study, and offers suggestions for the efficient management of working capital. At the end, bibliography is attached.

LIMITATIONS OF THE STUDY

All efforts have been made to carry out the study in an objective manner, still it suffers from several limitations. The main limitations are –

(1) The study is based on selected sample tyre companies only. Study can be conducted for the entire tyre industry. Thus the present study is constrained by the limitations of sample study.
(2) In order to make a study of working capital management more fruitful, it is essential that data should be of frequent time interval like monthly data. This study is based on published annual data which are available in balance sheet and profit and loss account. The use of annual data in this study is thus likely to effect the conclusions. Hence, the conclusions drawn in the present study should be taken in the light of this deficiency of the data.

(3) The study is limited to 10 years (1995-96 to 2004-05).

(4) The selection of companies is based upon the sales contribution and not upon profit contribution.

(5) Figures are being rounded off to two digits after decimal so results have been affected to that extent.

(6) The study might be having some unintentional human mistakes.