CHAPTER V

SUMMARY AND CONCLUSIONS:
Working capital management assumes great importance in any firm due to the frequency of decisions and the effect of such decisions on the firm's profitability, liquidity and structural health. Investment in working capital over and above the requirements unnecessarily blocks up firm's funds which could otherwise be used most productively. Thus the crux of working capital management is to achieve trade-off between liquidity and profitability, which in turn contributes to the sound structural health of a firm.

The working of the A.P. Paper Mills has been discouraging during the study period. This is revealed by the low net profit margin of the company. Both financial and non-financial factors are responsible for the present position of the company. Among the various financial problems, the problem of working capital management assumes great importance. The present study relates to working capital management in A.P. Paper Mills Ltd., which is situated in Rajahmundry in East Godavari District of Andhra Pradesh. The study covers a period of ten years from 1982-83 to 1991-92. The data and information have been collected from the annual reports of the company. The main observations of the study have been presented here.
Working capital is essential for the smooth running of any business concern. In the absence of adequate working capital, fixed assets also cannot be utilized efficiently. Both inadequate and excess working capital are dangerous to the firm. In this chapter an attempt has been made to appraise the management of working capital in A.P. Paper Mills by analysing the size, efficiency, structure and financing aspects of working capital.

The analysis of the size of working capital in A.P. Paper Mills revealed the following observations.

1. The Gross working capital has increased during the study period from Rs. 1841.23 lakhs in 1982-83 to Rs. 6864.99 lakhs in 1991-92 registering an increase of 273 percent.

The ratio current assets to total net assets is very high. It has increased from 49.70 percent in 1982-83 to 74 percent in 1989-90. The ratio of current assets to net fixed assets also has been showing substantial increase, which increased from 98.81 percent in 1982-83 to 284.60 percent in 1989-90. The ratio of working capital in terms of number of days of sales also showed increasing trend with some fluctuations. It was 181.76 days in 1982-83 increased to 277.65 days in 1988-89.
From this analysis it is clear that the size of working capital in A.P. Paper Mills Ltd, has been quite large and constituted a considerable percentage of total investments. This has led to low profitability as the current assets are less profitable than fixed assets.

Following observations were made by analysing the liquidity position of A.P. Paper Mills.

2. Both current ratio and quick ratio in A.P. Paper Mills have been on the lower side against the approved standard ratios of 2:1 and 1:1 indicating lower liquidity position. The presence of high amount of inventory in current assets further reduced the liquidity position.

3. The cash position ratio is very insignificant in A.P. Paper Mills. The ratio of net working capital to current assets is also quite unsatisfactory.

The liquidity analysis revealed that the liquidity position in A.P. Paper Mills is poor throughout the study period. Higher composition of inventory in current assets also led to low liquidity.

The efficiency of working capital has been analysed with the help of working capital turnover ratio and relative growth rate in working capital and sales. The following observations were made from this analysis.
4. The working capital turnover ratio was fluctuating. It is 2.01 times in the year 1982-83 which decreased to 1.65 times in the year 1988-89 and later on increased to 2.29 times.

5. Relative growth rate in sales and working capital revealed that the percentage increase in sales is not as much as the percentage increase in working capital.

From this analysis it is clear that working capital has not been efficiently utilised in A.P. Paper Mills.

The structural analysis revealed that the major component of working capital is inventory which constitutes 56 percent on an average, followed by receivables and cash and bank balances with an average of 37.03 percent and 6.95 percent respectively.

The overall analysis of working capital management in A.P. Paper Mills points to the need to reduce the investment in working capital.

By reducing investment in inventory the company can reduce its working capital. A firm can improve its liquidity position by decreasing current liabilities which will improve the current ratio. In A.P. Paper Mills the current ratio and quick ratios are below the standard norms. In order to improve these two ratios, the firm has to strengthen its liquidity position by investing more funds in liquid assets.
MANAGEMENT OF CASH AND DEBTORS:

Cash and debtors are the two most important components of current assets which determines the liquidity of a firm. The operating cycle of a firm begins with cash and ends with cash when debtors are collected. Over and under investment in these assets must be avoided. As the cash is the most idle of all current assets, cash balance beyond the requirements reduces the rate of return. Similarly excessive investment in debtors increases the probability of bad debts, collection costs. In this chapter an attempt has been made to evaluate the cash management and debtors management in two parts. Part I deals with the size, structure, operational adequacy of cash during the period. Part II deals with the size, composition and the relationship between growth in sales and debtors.

The following are the few observations:

1. The cash balance has been showing more fluctuating trend during the study period. It is ranging from Rs. 194.54 lakhs to Rs. 731.80 lakhs. The ratio of cash to current assets is 6.96 percent on an average and cash to sales is 3.78 percent on an average.
2. The structure of cash consists of cash on hand, cash at current accounts, cash at deposits and savings account and remittances in transit.

3. Operational adequacy of liquid assets in terms of number of days of operating expenses is 181 days on an average.

4. Cash balance in terms of number of days of operating expenses is very poor and on an average the cash is enough only for 15 days.

5. Both technical and actual liquidity is not satisfactory.

6. There is no relation between growth rate of sales and growth rate of cash balance. In some years there is negative growth rate in cash.

A.P. Paper Mills has to improve its cash balance position by exercising proper control on cash inflows and cash outflows. Cash budget and thereby bring out a regularity in them. This is particularly important as it can no longer depend upon external sources for its working capital requirements due to its poor liquidity position.

Part II deals with the management of Debtors, which includes trade debtors, loans and advances.

Receivables in A.P. Paper Mills has shown increasing trend which increased from Rs.322.68 lakhs in 1982-83 to
Rs.2861.17 lakhs in 1991-92 registering an increase of more than 785 percent over base year. Analysis of the structure of debtors showed that the increase in sundry debtors was more than 2750 percent over the base year which is more than the rate of increase in total receivables. Comparison of receivables with other assets revealed the following observations:

1. The ratio of receivables to total assets has been showing increasing trend and constituted 23.07 percent on an average during the study period. Sundry debtors, loans and advances occupied 11.79 percent and 11.27 percent on an average respectively.

2. The ratio of receivables to current assets constitute 35.01 percent on an average of which sundry debtors and loans and advances constitute 17.92 percent and 17.09 percent on an average.

The analysis of the efficiency of debt collection has revealed the following observations:

Debtors turnover ratio has shown decreasing trend and the average collection period has shown increasing trend during the study period. However the proportion of debts outstanding over six months in total debtors has decreased during the study period which is a significant improvement.
The relative growth rate in debtors and sales indicate that the average rate of growth in debtors (105.03 percent) is more than the average rate of growth in sales (16.47 percent) during study period.

From these observations, it can be concluded that the investment in debtors is not utilized properly and management has failed in collecting debts in time. The management of A.P. Paper Mills has to take utmost care in collecting debts, so that cash inflow position can be improved. Secondly the investment in loans and advances component of receivables would have to be minimised.

(R.T.O.)
Chapter - XV

Inventory Management:

Inventory consists of raw-material, stock-in-process, finished goods, material in transit, spares in process and in A.P. Paper Mills. The stock of scrap constitutes 57.85 percent of current assets.

In this chapter, an attempt has been made to analyze the size, structure, efficiency, and adequacy of inventory in A.P. Paper Mills during the study period.

The size of inventory increased from Rs.1323.98 lakhs in 1982-83 to Rs.3738.17 lakhs in 1991-92 registering a growth rate of more than 180 percent. Component-wise analysis indicated that stock in process inventory increased abnormally followed by raw-material, finished goods and material in transit.

Comparison of the size of inventory with other assets has been done by calculating ratios such as inventory to total net assets ratio, inventory to current assets ratio, and inventory to net working capital ratio. The following observations are made from this analysis.

1. The ratio of inventory to total net assets in A.P. Paper Mills has been fluctuating during the study period.

2. The ratio of inventory to current assets has shown decreasing trend during the study period. It is 71.90 percent
in 1982-83 decreased to 55.45 percent in 1991-92, on an average constituting 57.85 percent.

3. The ratio of inventory to net working capital is showing decreasing trend throughout the study period. It is 868.22 percent in 1983-84 decreased to 139.19 percent in 1991-92. The decreasing trend in inventory is a healthy sign from the point of view of liquidity.

From these observations, it can be concluded that the size of inventory is very large in A.P. Paper mills. The position of inventory during the last three years of the study period indicates the measures taken by the management to keep the inventory under control.

4. The structural analysis of inventory revealed that raw-materials consists major portion of inventory followed by finished goods and materials in transit. Hence the company has to improve the raw-material and finished goods turnover.

Efficiency analysis of inventory is done with the help of inventory turnover ratios and relative growth rate in sales and inventory. This revealed that

5. The overall inventory turnover ratio was ranging between 2.59 to 4.44.

6. Deviations between actual and estimated inventory identified through regression analysis are unfavourable during the years 1986-87 1988-89 and 1991-92.
Therefore it can be concluded that the firm's investment in inventory is not justified and it has to reduce its inventory levels so that its liquidity and profitability can be improved.

The inventory composition should be reduced to the maximum extent, especially slow moving items like stores and spares and stock in process. The investment in raw-material also should be reduced to a maximum possible extent. However a rational approach which balances cost of extra inventories against the expected benefits is needed which will decide the optimum level of inventories.