CHAPTER 2: REVIEW OF LITERATURE

Review of literature is a process of developing an insight into both conceptual and research based studies available on the area and the topic chosen. The objective of such review is to understand the importance of the topic and find out research gaps, if any in the chosen area. Thus review of literature in the present study does comprise the following studies and observations.

Mishra, R.K. (1975) in the study on “Problems of working capital- with reference to selected public undertakings in India” revealed that there were fundamentally four basic problem areas concerned with cash, debtors, inventory and financing of working capital in the sample companies. It was due to these chronic problems that the sample companies failed miserably in achieving the effective management of working capital. The study has addressed the dire need for efficient and effective usage of funds in order to achieve efficient working capital management.12

Vijayasaradhi, S.P and K. Rajeswara Rao (1978), in their study on “Working capital investment and financing in public enterprises” showed that the management of working capital played a key role in the success of the business. The study has indicated that increasing trend in the investment of current assets, unlike in fixed assets, has resulted in higher carrying costs which in turn has negatively affected the profitability position of the company.13

Banerjee, Bhabathosh, (1979), in his study on “Working capital turnover ratios and cash management” established the relationship between liquid ratio, debtors’ turnover ratio, creditors’ turnover ratio and the movement of overdraft. The study found that the liquidity ratio was below the norm, debtors’ and creditors turnover ratios were high and overdraft showed declining trend. He demonstrated how turnover ratios would affect the financial performance of a given company. The study concluded that the management of working capital was not satisfactory.14

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Ghosh, S.P. (1983), in his study on “Working capital in crane manufacture- a case study” The study concluded that the management of individual components of working capital was erratic. The study recommended the immediate need for streamlining the working capital management practices. Khandelwal, N.M. (1985), in the study on “Working capital management in small scale industries” investigated working capital management process and practices among the selected units of 40 small scale industries in Jodhpur Industrial State between the years 1975-1980. The study revealed that the sample firms held more investments in inventories than required and management of receivable was not found satisfactory or orderly. It was found that bills receivables constituted as much as 50% of total current assets. Highlighting the sickness in Jodhpur Industrial Estate the study attributed the main reason is inefficient management of working capital. The study suggested that the entrepreneurs need to be educated about the basic concepts and efficient way of working capital management. Rajeswara, Rao K. (1985), in his study on “Working capital planning and control in public enterprises in India” attempted to assess the degree of effective management of working capital components with a special emphasis on inventories. The study showed that no sample company clearly defined working capital policies and hence majority of them could not achieve efficiency in working capital management. The study also revealed that the investment in inventories in sample units soared up from 63% in 1971-72 to 66% in 1976-77. It was further found that majority of such investment was made in finished goods inventory which indicated that the units did not manage the working capital in planned way. The study recommended to recognize prudent management of working capital as a vital part of financial management.
Panda, G.S. (1986), in the study on “Management of working capital in small scale industries” made a survey of small scale units in the state of Orissa, examines the issues like optimum investment of funds in current assets, relationship between sales growth and working capital needs. The study pointed that management of working capital was neglected by majority of sample units, which lead to incurrence of loss. It was found that long-term funds were highly limited to the firms and hence majority of

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small scale industries depended on short-term credit in meeting working capital requirements\textsuperscript{18}.

Sinha, K.P, Sinha A.K. and Singh S.C. (1988), in their study on “Management of working capital in India” conducted a survey of analysis of working capital management in Fertilizer Corporation of India and Gujarat State Fertilizer Corporation. They asserted that a huge proportion of funds were tied up as working capital especially in inventories and receivables. The study also indicated that the sample companies failed to manage working capital efficiently and hence the funds were locked up at various levels during the course of business operations. The study recommended for urgent need for streamlining working capital management practices.

Jain, R.K.(1988), in his study on “Working capital management of state enterprises in India” He analyze various working capital management practices followed ten manufacturing, trading and service companies/ industries in state of Rajasthan. The study found out that the companies had both over investment and under investment problems. The study strongly recommended for the release of excess funds in working capital and to invest the same in short-term or long-term assets. On the other hand, the study recommended that the companies should avoid under investment in working capital if they wanted higher profit margins\textsuperscript{19}.

Oppedahl and Richard A. (1990), in the study on “Working capital management” expressed capital budgeting projects consume much of the time of a firm’s management group to the detriment of the quality of the working capital decisions. It emphasized that the business executives must become cognizant of the working capital decisions that their firms face every day. The stress has been laid on two most important components of working capital called accounts receivable and marketable securities. They revealed that the managers had to be very cautious in accounts receivables and marketable securities decisions\textsuperscript{20}.

Rao K.V and N.Chinta Rao(1991), in their study on “Evaluating efficiency of working capital management- are the conventional techniques adequate”, in their survey among few public sector enterprises belonging to manufacturing sector in the state of Karnataka, have attempted to probe into the capacity of the various techniques

\textsuperscript{18}Panda, G.S., (1986), Management of working capital in small scale industries, New Delhi, Deep and Deep publishers.


in evaluating working capital efficiency of business enterprises. The study revealed that the working capital planning and control was found to be disorderly and ineffective and hence, they suggest urgent need for full focus on working capital management.\textsuperscript{21}

Suk, H, Seung Kim H and Rowland(1992), in the study on “Working capital practice of Japanese firms in the U.S.” in their survey conducted on 94 Japanese companies in U.S revealed that the Japanese companies differed in working capital management practices from U.S companies in terms of lower levels of inventory and higher levels of accounts receivables. The study also found that more than 70% of the time Japanese investors used outside financing as a major sources of short term financing.\textsuperscript{22}

Siddharth, M.R and Das G. (1994), in the study on “Working capital turnover in Pharmaceutical companies” have attempted to ascertain efficient or otherwise use of working capital in selected pharmaceutical firms in India. The overall analysis of the data indicated that the selected companies did very well in terms of employment of working capital.\textsuperscript{23}

Mohan, Reddy, P.(1995), in his study on “Management of working capital”, studies various issues related to working capital management among selected (six companies) private large – scale companies in the state of Andhra Pradesh during the period from 1977 to 1986 . The study revealed that investment in current assets was more than that of fixed assets and inventories constituted highest percentage of total current assets. Study also pointed out that the liquidity and solvency position of sample units was found to be highly unsatisfactory .He based on his findings, suggested the dire need for improvement of liquidity and solvency position of sample companies failing which the situation would lead to serious liquidity crunch\textsuperscript{24}.

Romero, R. Richard (1995), in the study on “Invest working capital for better returns” felt that the investment in working capital has to be capitalized. They said that the goals of investment in working capital were twofold: to find income producing opportunities for cash that is temporarily idle, to maximize yield and to maintain the

liquidity of the investment. With his experience as associate financial consultant with Merrill Lynch’s Private client group in Arlington Mr. Romero felt that the firms have to have concrete formula of optimum investment in working capital.\textsuperscript{25}

Bhattacharya, Hrishikes (1995), in his book on “\textit{Total Management by Ratios}” says that problem of liquidity management is more acute for companies which are growing at a fast rate. The rising cash flow (profit) curves gives a euphoric feeling of “all being well everywhere”, which makes the managers to press the growth button faster. That may lead to decline in cash position of the company because of the increase in expenses for growth, which can lead to severe liquidity crisis. Unfortunately, once manager presses the growth buttons, it is difficult for him to retract the steps. The continuous erosion of liquidity ultimately makes a high-growth company sick. There is nothing wrong in making profit, in fact, that is the purpose of business, but unless there is cash coming through profit, an enterprise will soon be dead\textsuperscript{26}.

Indrasena, Reddy P. and K. Someswar (1996), in their survey on “Working capital management in public sector undertakings- a case study,” conducted a study in Hindustan Cables Ltd. for the period from 1989-1994. Having studied current ratio, quick ratio, working capital turnover ratio, inventory turnover ratio, debtors turnover ratio, current assets turnover ratio and average collection period, concluded that liquidity position of the company was unsatisfactory. However, the study revealed that there was a sign of improvement in the management of inventory and ineffectiveness in the management of debtors. The study recommended for effective utilization and control of current assets\textsuperscript{27}.

Sur, Debashish (1997), in the study on “Working capital management in Colgate Palmolive- India Ltd.- A case study” attempted to assess the efficiency of working capital management. The study revealed that the working capital management was inefficient during the study period. He recommended special attention to the management of inventories which constituted the highest part of current assets\textsuperscript{28}.

\textsuperscript{26} Bhattacharya, Hrishikes, (1995), \textit{Total Management by Ratios}, Chapter 6, New Delhi, Sage Publications.
\textsuperscript{27} Indrasena, Reddy P. and K. Someswar, (1996), ”Working capital management in public sector undertakings- a case study,” The management accountant, 643-645
Shanmugam and Poornima (2001), in the study on “Working capital is still most crucial,” the authors studies 28 medium and large scale spinning mills in Coimbatore Industrial Area (Tamil Nadu) revealed that effective working capital management is still most crucial in organisation’s success. The study explained that most of the industries (10 mills) depended on production plans in working capital planning leaving all norms aside. The budgetary control was found to be the widely applied criterion of working capital control. When researchers interviewed the CEO of the sample companies, it has come out that every CEO spent majority of the time on working capital management, which in turn highlights the importance of working capital management.29

Sathyamoorthi, C. R. (2002), attempted a study on “Management of working capital in selected co-operatives in Botswana”, to ascertain how the current assets were financed and also to discover the relative importance of various current assets components. The study analysed four years data of selected cooperative organizations in Botswana and found that the liquidity ratios played a vital role to evaluate the short term efficiency of the organization. The study showed that the co-operatives had low liquidity resulting in weak position to pay short term debts. The survey also revealed that co-operatives were in action working towards a break-through to be achieved.30

Singh, P.K. (2004), in the study on “Working capital management in Lupin laboratories Ltd. - A case study” attempted to assess the significance of management of working capital through working capital ratios and operating cycle. The study brought out the need for efficient management of debtors, the percentage of which was highest.31

Parasuraman, N.R. (2004), in the study on “Working capital practices in leading pharmaceutical companies- A view of the credit policy & profitability” attempted to understand the relationship between credit period given by the companies and their actual performance in terms of sales and profitability. He found that leading companies had employed greater working capital for enhancing profitability. The study also revealed that Days Sales Outstanding had gone up in the sample companies. Though the rise was marginal, it played an important role in the

management of working capital. The study inferred that the top pharmacy companies strategise on their working capital policy to relax the credit policy to achieve greater sales and greater profits.

Abuzar M.A. Elijelly (2004), in the study on “Liquidity – profitability tradeoff: An empirical investigation in an emerging market” empirically examined the relation between profitability and liquidity, as measured by current ratio and cash gap (cash conversion cycle) on a sample of joint stock companies in Saudi Arabia. The study found significant negative relation between the firm’s profitability and its liquidity level, as measured by current ratio.

Dr. Ahmad Rais, Dr. Gufran Ali (2005), in their study on “An analytical study of working capital management of marketing cooperative societies” concluded that the working capital management in Marketing Cooperatives of Uttar Pradesh is not satisfactory causing inefficiency in working performance of these societies. The management of these societies must take immediate necessary steps to improve the position of working capital management.

Sushma Vishnani, Bhupesh Kr. Shah (2005), in the study on “Impact of working capital management policies on corporate performance- An empirical study”, have concluded that if a company desires to take greater risk, it reduces the size of its working capital in relation to its sales. If it is interested in improving its liquidity, it increases the level of its working capital. However, this policy is likely to result in a reduction of the sales volume, therefore, of profitability also.

Lazaridis, Ioannis, Tryfonidis, Dimitrios, (2006), in their paper on “Relationship Between Working Capital Management and Profitability of Listed Companies in the Athens Stock Exchange” investigated the relationship of corporate profitability and working capital management. Used a sample of 131 companies listed in the Athens Stock Exchange (ASE) for the period of 2001-2004. The results of research showed that there is statistical significance between profitability, measured through gross operating profit, and the cash conversion cycle. Moreover managers can create profits

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32 Parasuraman, N.R., (December 2004). Working capital practices in leading pharmaceutical companies- A view of the credit policy & profitability, The management accountant, 39(12), 998-1005
34 Dr. Ahmad Rais & Dr. Gufran Ali (2005). An analytical study of working capital management of marketing cooperative societies, Monthly public opinion surveys, May 2005, 18-28
for their companies by handling the cash conversion cycle correctly and keeping each
different component (accounts receivables, accounts payables, inventory) to an

Garcia-Teruel and Martinez-Solano (2007), in the study on “Effects of working
capital management on SME profitability” studied the effects of working capital
management on the profitability of a sample of small and medium-sized Spanish
firms. They found that managers can create value by reducing their inventories and
the number of days for which their accounts are outstanding. Moreover, shortening

Adolphusj.Toby (2008), in the paper on “Liquidity performance in Nigerian
manufacturing companies” the author investigates the empirical relationship between
liquidity and other performance measures in Nigerian manufacturing companies. The
result shows statistically significant relationships between liquidity and profitability,

P.K. Das (2008), in “A study on Liquidity Management in Ranbaxy Laboratories
Ltd.” analysed the liquidity position of the company through several measures like
ratio analysis, correlation analysis, t- Test, liquidity ranking etc., revealed that the
overall liquidity position of the company was satisfactory.\footnote{Das, P.K., (2008). A study on liquidity management in Ranbaxy laboratories ltd., The Journal of accounting and finance, 22(1), 135-149}

Chakraborty (2008), in the study on “Working Capital and Profitability: An Empirical
Analysis of Their Relationship with Reference to Selected Companies in the Indian
Pharmaceutical Industry” evaluated the relationship between working capital and
profitability of Indian pharmaceutical companies. He pointed out that there were two
distinct schools of thought on this issue: according to one school of thought, working
capital is not a factor of improving profitability and there may be a negative
relationship between them, while according to the other school of thought, investment
in working capital plays a vital role to improve corporate profitability, and unless
there is a minimum level of investment of working capital, output and sales cannot be
maintained - in fact, this is the good management of working capital which result in optimum utilization of fixed assets. Singh and Pandey (2008), by their study on “Impact of Working Capital Management in the Profitability of Hindalco Industries Limited” suggested that, for the successful working of any business organization, fixed and current assets play a vital role, and that the management of working capital is essential as it has a direct impact on profitability and liquidity. They studied the working capital components and found a significant impact of working capital management on profitability for Hindalco Industries Limited.

Mathuva (2009) in his study on “The influence of working capital management components on corporate profitability: a survey on Kenyan listed firms” examined the influence of working capital management components on corporate profitability by using a sample of 30 firms listed on Nairobi Stock Exchange for the periods 1993-2008. He used Pearson and Spearman’s correlations, the pooled ordinary least squares and the fixed effects regression models to conduct data analysis. The key findings of his study were that there exists a highly significant negative relationship between the time that firms took to collect cash from their customers and profitability, there exists a highly significant positive relationship between the period taken to convert inventories to sales and profitability and there exists a highly significant positive relationship between the time it taken by firms to pay its creditors and profitability.

James Clausen (2009), in the article on “Accounting 101 – Financial Statement Analysis in Accounting: Liquidity Ratio Analysis Balance Sheet Assets and Liabilities” analysed the financial statements to measure company performance. Investors and lending institutions will often use ratio analysis of the financial statements to determine a company’s profitability and liquidity. If the ratios indicate poor performance, investors may be reluctant to invest.

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Gopinathan Thachappilly (2009), in his study on “Financial Ratio Analysis for Performance Check: Financial Statement Analysis with Ratios Can Reveal Problem Areas” stated that the Liquidity Ratios help good financial performance. More profitability can lead to severe implications on liquidity of the business which causes damage to the reputation of the company and can cause financial troubles. So the financial position of the company is being analysed on the basis of various ratios to ascertain the profitability & Liquidity position⁴⁴.

Kaiser Kevin and Young David S (2009). in their article on “Need Cash? Look Inside Your Company” had taken a hard look at the way company manages its working capital. He identified that a lot of capital tied up in receivables and inventory could be turned into cash by challenging the working capital practices and policies of the company. He had explored some common mistakes that companies make in managing working capital. He says that the simple act of correcting them could free up enough cash to make the difference between failure and survival in the current recession⁴⁵.

Dr. Palaniappan, A. and Velusamy, P. (2009), in their study on “Capital structure, liquidity and profitability of chemical industry in India” an attempt is made in this study to analyze the behavior of fixed and working capital of the chemical industry of large public limited companies. Through ratios, percentages, growth rates, coefficient of variation, correlation etc, the authors concluded that chemical industry had registered a positive annual growth rate in gross profit margin during the study period. From the point of view of gross profit margin, overall performance is good in chemical industry⁴⁶.

Bhunia Amalendu (2009), in his paper on “Financial performance of Indian pharmaceutical industry- A case study” attempted to measure the firm’s liquidity, profitability, and other indicators that the business is conducted to maximize shareholder’s wealth. In this context researcher has undertaken an analysis of pharmaceutical companies to understand how management plays a crucial role in the growth. The study covers two public sector drug & pharmaceutical enterprises listed on BSE in between 1887-98 to 2008-09. In order to analyze financial performance in

⁴⁶Dr. Palaniappan, A. & Velusamy, P. (2009), Capital structure, liquidity and profitability of chemical industry in India, Prabandhan: Indian journal of management, 44-53
terms of liquidity, solvency and profitability and financial efficiency, various accounting ratios have been used. Statistical measures i.e. linear multiple regression analysis and test of hypothesis- t-test has been used. He found that the liquidity position of the selected companies is strong. Moraes, Sherin,(2010) in her article on “Liquidity v/s profitability - Striking the right balance” writes about the implications of liquidity and profitability in a pharmaceutical company. A firm is required to maintain a balance between liquidity and profitability while conducting its day to day operations. Investments in current assets are inevitable to ensure delivery of goods or services to the ultimate customers. A proper management of the same could result in the desired impact on either profitability or liquidity.

Dr. Ramudu Janaki P. (2010) in his study on “Working capital structure and liquidity analysis: An empirical research of Indian commercial vehicles industry”, the study is conducted among five commercial vehicle companies which constitute Indian Commercial Vehicles Industry for ten years 1995 to 2004 through ratios, averages and application of ANOVA. Attempt was made to study effectiveness of structuring the working capital, the study revealed that the sample companies on an aggregate basis invested most of their funds in inventories followed by trade receivables and loans and advances. The firms had held very insignificant amount of funds in cash and near cash assets. The study also revealed that the variation between current assets turnover ratio and working capital turnover ratio was very high across the industry which, in turn, implies that the sample companies achieved higher sales with less working capital. The application of coefficient of correlation revealed that the current assets of Bajaj Tempo Ltd., Eicher Motors Ltd., and Swaraj Mazad Ltd., varied significantly with sales and all sample companies were efficient in terms of achieving higher sales with lower levels of current assets.

Jain P.K., Singh Shveta and Kapoor Sunny (2011) in their study on “Working capital management of Reliance Industries Limited- A case study” in the period 2000-2009 has been attempted to establish whether the concept of zero working capital (zwc) is

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47 http://ipublishing.co.in/ajmrvol1no1/EIJMRS1034.pdf
evident in the way India’s largest corporate manages its operations. In the event of an inefficient working capital management, the flow of money gets choked, supplies are interrupted and payments delayed. While inadequate working capital has the potential to disrupt production / sales operations of otherwise well-run and well-managed business enterprises, excessive working capital has adverse impact on profitability and, therefore, is equally undesirable. Thus there is an imperative need to manage working capital effectively. Working capital management can also be understood as the managerial accounting strategy focusing on maintaining efficient levels of both components of working capital viz., current assets and current liabilities, in respect to each other. The study found that there is presence of / adherence to the concept of zero working capital (zwc) in Reliance Industries Ltd50.

Agarwal Anusha (2011) in her study on, “How to manage working capital. An empirical study of Maruti Suzuki India limited” found that efficient liquidity management involves planning and controlling current assets and current liabilities in such a manner that eliminates the risk of the inability to meet due short-term obligations on the one hand and avoids excessive investments in these assets on the other. This is, due in part, to the reduction of the profitability of running out of cash in the presence of liquid assets. The working capital approach to liquidity management has long been the prominent technique used to plan and control liquidity. The working capital includes all the items shown on a company’s balance sheet as short term or current assets, while net working capital excludes current liabilities. This measure is considered a useful tool in assessing the availability of funds to meet current operations of companies. Based on this theoretical background, the research paper evaluates the liquidity, profitability and risk trade-off of Maruti Suzuki India Limited (MSIL), a premier car manufacturer and the biggest seller in India. The study found that the company is giving due consideration to its working capital policies51.

On the basis of the literature reviewed liquidity may be regarded as the life blood of any business unit. Its effective management can do much more to the success of the business while its ineffective management will undoubtedly lead to its failure. It is in this context that liquidity management assumes paramount importance. The analysis of liquidity aspect helps the management to get information about the adequacy of

working capital. The results indicated a close relationship between profitability and liquidity emphasizing the need to exercise better control over working capital. Although it is an established fact that there is a close relationship between liquidity and profitability, the research work would be an extension in the field of companies listed in NIFTY to know how a finance manager can maximize profitability while optimizing liquidity.