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WORKING CAPITAL MANAGEMENT OF ANDHRA CEMENT LIMITED - A STUDY

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INTRODUCTION

Every business needs investment to procure fixed assets, which remain in use for a longer period. Money invested in these assets is called 'Long term funds' or 'Fixed capital'. Business also needs funds for short term purposes to finance current operations. Investment in short term assets like cash, inventories, debtors etc. is called 'short- term Funds' or Working capital'. The 'working capital' can be categorized, as funds needed for carrying out day-to-day operations of the business smoothly. The management of working capital is equally important as the management of long-term financial investment. Every running business needs working capital. Even a business which is fully equipped with all types of fixed assets required is bound to collapse without (1) adequate supply of raw materials for processing, (2) cash to pay for wages, power and other costs, (3) creating a stock of finished goods to feed the market demand regularly, and (4) the ability to grant credit to its customers. All these require working capital. Working capital is thus like the lifeblood of a business. The business will not be able to carry on day-to-day activities without the availability of adequate working capital.

Working capital cycle involves conversions and rotation of various constituents/components of the working capital. Initially 'cash' is converted in to raw materials. Subsequently, with the usage of fixed assets resulting in value additions, the raw materials get converted in to work in progress and then in to finished goods. When sold on credit, the finished goods assume the form of debtors who give the business cash on due date. Thus 'cash' assumes its original form again at the end of one such working capital cycle but in the course it passes through various other forms of current assets too. This is how various components of current assets keep on changing their forms due to value addition. As a result, they rotate and business operations continue. Thus, the working capital cycle involves rotation of various constituents of the working capital.

STRUCTURE OF WORKING CAPITAL

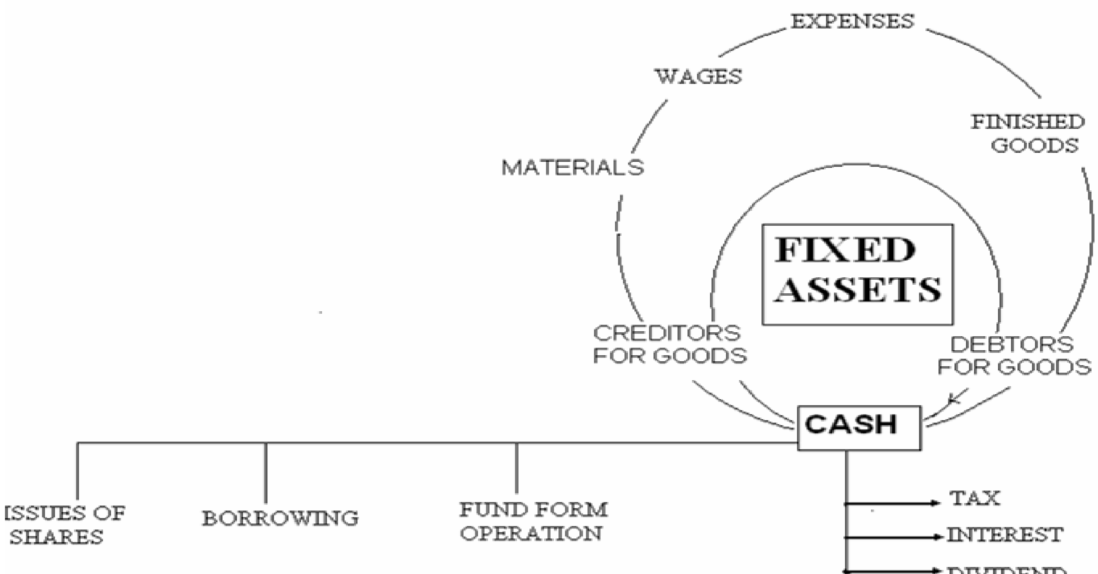
The different elements or components of current assets and current liabilities constitute the structure of working capital which can be illustrated in the shape of a chart as given below:

Structure of Current Assets and Current Liabilities

Current Assets	Current Liabilities
Cash and Bank Balance	Bank Overdraft
Inventories: Raw-Materials Work-in-progress Finished Goods	Creditors
Spare Parts	Outstanding Expenses
Accounts Receivables	Bills Payable
Bills Receivables	Short-term Loans
Accrued Income	Proposed Dividends
Prepaid Expenses Short-term Investments	Provision for Taxation, etc.

CIRCULATION OF WORKING CAPITAL

Both the current assets and current liabilities exist in the business at one given time. The current assets and current liabilities are flowing round in a business like an electric current. However, "The working capital plays the same role in the business as the role of heart in human body. Working capital funds are generated and these funds are circulated in the business. As and when this circulation stops, the business becomes lifeless. It is because of this reason that the working capital is known as **circulating capital** as it circulates in the business just like blood in the human body.



CIRCULATION SYSTEM OF WORKING CAPITAL

The sale of goods may be for cash or credit. In the former case, cash is directly received while in later case cash is collected from debtors. Funds are also generated from operation and sale of fixed assets. A portion of profit is used for payment of interest, tax and dividends while remaining is retained in the business. This cycle continues throughout the life of the business firm.

CLASSIFICATION OF WORKING CAPITAL

The quantitative concept of Working Capital is known as gross working capital while that under qualitative concept, it is known as net working capital.

Working capital can be classified in various ways. The important classifications are as given below:

Conceptual classification

There are two concept of working capital *viz.*, quantitative and qualitative. The quantitative concept takes into account as the current assets while the qualitative concept takes into account the excess of current assets over current liabilities. Deficit of working capital exists where the amount of current liabilities exceeds the amount of current assets. The above can be summarized as follows:

i. Gross Working Capital = Total Current Assets
ii. Net Working Capital = Excess of Current Assets over Current Liabilities

iii. Working Capital Deficit = Excess of Current Liabilities over Current Assets.

Classification on the basis of financial reports – The information of working capital can be collected from Balance Sheet or Profit and Loss Account; as such the working capital may be classified as follows:

i. **Cash Working Capital** – This is calculated from the information contained in profit and loss account. This concept of working capital has assumed a great significance in recent years as it shows the adequacy of cash flow in business. It is based on 'Operating Cycle Concept'.

ii. **Balance Sheet Working Capital** – The data for Balance Sheet Working Capital is collected from the balance sheet. On this basis the Working Capital can also be divided in three more types, *viz.*, gross Working Capital, net Working Capital and Working Capital deficit.

Classification on the Basis of Variability – Gross Working Capital can be divided in two categories *viz.*,(i)Temporary, seasonal or variable working capital, (ii) permanent or fixed working capital. Such type of classification is very important for hedging decisions.

i. **Temporary Working Capital** – Temporary Working Capital is also called as fluctuating or seasonal working capital. This represents additional investment needed during prosperity and favourable seasons. It increases with the growth of the business. "Temporary working capital is the additional assets required to meet the variations in sales above the permanent level." This can be calculated as follows:

   Temporary Working Capital = Total Current Assets – permanent Current Assets

ii. **Permanent Working Capital –** It is a part of total current assets which is not changed due to variation in sales. There is always a minimum level of cash, inventories, and accounts receivables which is always maintained in the business even if sales are reduced to a minimum. Amount of such investment is called as permanent working capital. "Permanent Working Capital is the amount of working capital that persists over time regardless of fluctuations in sales." This is also called as regular working capital.

IMPORTANCE OF WORKING CAPITAL MANAGEMENT

For smooth running of an enterprise, an adequate amount of working capital is very essential. The aim of working capital management is to manage a firm's current assets e.g. debtors, receivables, cash in hand, cash at bank, stock etc. and firm's current liabilities viz. creditors, bills payable etc. in best possible manner.

Efficiency in this area can help, to utilize fixed assets gainfully, to assure the firm's long term success and to achieve the overall goal of maximization of the shareholders, fund. Shortage or bad management of cash may result in loss of cash discount and loss of reputation due to non-payment of obligation on due dates. Insufficient inventories may be the main cause of production held up and it may compel the enterprises to purchase raw materials at unfavourable rates. Like-wise facility of credit sale is also very essential for sales promotions. It is rightly observed that "many a times business failure takes place due to lack of working capital." Adequate working capital provides a cushion for bad days, as a concern can pass its period of depression without much difficulty.

O' Donnel explained the significance of adequate working capital and mentioned that "to avoid interruption in the production schedule and maintain sales, a concern requires funds to finance inventories and receivables."

The adequacy of cash and current assets together with their efficient handling virtually determines the survival or demise of a concern. An enterprise should maintain adequate working capital for its smooth functioning. Both, excessive working capital and inadequate working capital will impair the profitability and general health of a concern.

The danger of excessive working capital are as follows:

(1) Heavy investment in fixed assets – A concern may invest heavily in its fixed assets which is not justified by actual sales. This may create situation of over capitalisation.

(2) Reckless purchase of materials- Inventory is purchased recklessly which results in torpid slow moving and obsolete inventory. At the same time it may increase the cost due to mishandling, waste, theft, etc.

(3) Speculative tendencies - Speculative tendencies may increase and if profit is increased dividend distribution will also increase. This will hamper the image of a concern in future when speculative loss may start.

(4) Liberal credit - Due to liberal credit, size of accounts receivables will also increase. Liberal credit facility can increase bad debts and wrong practices will start, regarding delay in payments.

(5) Carelessness - Excessive working capital will lead to carelessness about costs which will adversely affect the profitability.

Dearth/Paucity of working capital is also bad and has the following dangers:

(1) Implementation of operating plans becomes difficult and a concern may not achieve its profit target.

(2) It is difficult to pay dividend due to lack of funds.

(3) Bargaining capacity is reduced in credit purchases and cash discount could not be availed.

(4) Operating inefficiencies may creep in when a concern cannot meet it financial promises.

(5) An enterprise looses its reputation when it becomes difficult even to meet day-to- day commitments.

(6) Stagnates growth as the funds are not available for new projects.

(7) A concern will have to borrow funds at an exorbitant rate of interest in case of need.

(8) Sometimes, a concern may be bound to sale its product at a much reduced rates to collect funds which may harm its image.

SCOPE AND PURPOSE OF PRESENT PAPER

The present study "Working Capital Management of Andhra Cement Ltd.: An Appraisal" analyses the efficiency of the working capital management and its components i.e. inventory amount, cash and bank balances and various current liabilities of Andhra Cements Ltd.. The study attempts to determine the efficiency and effectiveness of management in each segment of working capital. Since the net concept of working capital has been taken in the present study, management of both current assets and current liabilities will be critically reviewed.

The importance of the study is emphasized by the fact that the manner of administration of current asset and current liabilities determined to a very large extent the success or failure of a business. The efficient and effective management of working capital is of crucial importance for the success of a business, which involves the management of the current assets and the current liabilities. The business concern has therefore to optimize the use of available resources through the efficient and effective management of the current assets and current liabilities. This will enable to increase the profitability of the concern and the firm could be able to meet its current obligation will in time.

HYPOTHESES OF THE STUDY

The study has been pursued to test the following hypotheses with reference to Cement Industry in India:

- That proper management of working capital improves both 'Liquidity and Profitability' position of a business firm.
- That external sources of finance particularly bank borrowing are being liberally utilized in financing the working capital requirement of industry in India.
- That the scope for improvement in the management of working capital is greater in inventory as well as receivables management than in cash management.

- That the private sector of the industry is definitely in a better position than the public sector, as far as management of working capital is concerned.

OBJECTIVES OF THE STUDY

The present study has been undertaken to achieve the following objectives with regard to management of working capital in Andhra Cement Ltd.:

- To evaluate the inventory, receivable and cash management performance of Andhra Cements Ltd.
- To establish a relationship between working capital management and profitability.
- To examine the combine effect of the working capital ratios on profitability.
- To determine the working capital leverage for examining the sensitivity of ROI to changes in the level of gross working capital of the company.
- To find out the fluctuations arising in working capital in Andhra Cements Ltd. due to its nature of demand and supply, production, government policies.
- To analyze the growth in the sector of production and installation policies and capacities during five year plans.
- To compare the selected units of the private sector regarding management of working capital.
- To analyze the impact of cement industry on the national economy.
- To analyze new technique in Andhra Cement Ltd. with a view to cutting costs and increasing efficiency in production and distribution so as to raise the level of production and consumption.
- To know the profitability of Andhra Cement Ltd. and its impact on working capital.

METHODS OF STUDY

In the present study, Andhra Cement Ltd. has been selected. However for comparative study information of few other top cement companies has been taken. As the case study of Andhra Cement Ltd., the company will be selected on the basis of capital employed. Obviously, it will be a comparative study through empirical methods of the study. Simultaneously, interview of top official in Andhra Cement Ltd. and other selected companies would be arranged to make the empirical aspect more meaningful.

Besides these empirical methods of study, a histro-descriptive method would also be used in order to make the study academically significant and practically important exercise.

The data relating to management of working capital of Andhra Cement Ltd. and few other selected units has been collected from the published annual reports of the companies for the year 2003-04 to 2015-2016 which were directly obtained from the registered offices of respective companies. In addition to this primary data about practices, policies and procedures followed in the management of working capital in the Andhra Cement Ltd. and other selected units have been collected through personal discussions with the top executives of the units. This data was supplemented by information collected from various books, journals, newspapers and articles relating to industry. With the help of data related to the study, various selected statements and ratios have been calculated; fund flow and cash flow statements have been prepared and interpreted through different statistical techniques analysis of variance, coefficient of correlation and regression etc. With the help of conclusions drawn, suggestions have been presented to improve the efficiency of management of working capital in the industry. In the course of analysis in the study, use of various accounting and statistical techniques have been made. Accounting technique includes ratio analysis and funds flow statement.

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