DYNAMICS OF WORKING CAPITAL MANAGEMENT OF AMBUJA CEMENT COMPANY – AN ANALYSIS

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ABSTRACT

Working capital is the most vital part of any business firm. Working capital management is the key to success for the manufacturing firm. As a manufacturing firm the profitability of cement industry mainly depends on the efficient management of working capital. Efficient management of working capital is a fundamental part of the overall corporate strategy in creating shareholders’ value. Today, the management of Working Capital is one of the most important and challenging aspects of overall financial management. Optimization of working capital balance means minimizing working capital requirements and realizing maximum possible revenues. Efficient WCM increases firms’ free cash flow, which, in turn, increases the firms’ growth opportunities and returns to shareholders. Even though firms are traditionally focused on long term capital budgeting and capital structure, the recent trend is that many companies across different industries focus on WCM efficiency.

The paper attempts to present an analysis of the relation between the different working capital ratios of Ambuja Cement Company from top ten cement manufacturing companies of India. This study is based only upon secondary data and related data was collected from website of company, company’s annual reports and financial websites like money control .com for Five years 2012-2016.

Key words: Working capital management, Cement Industry, Financial Ratios.

Introduction:

Cement industry is one of the important industries to country development in the light of the main important basis for construction industry and also the important indicator showing domestic economic growth. In the past, the domestic demand of cement used to be up to 36 million tons. But, the severely negative effects from economic crisis in 1997 have caused real estate and construction industry subdued; the domestic demand of cement has shrunk and been in oversupply atmosphere. Until 2001–2003, the government has launched many economic actuating policies. This has made real estate and construction industry recovered and the demand of cement has been increasing gradually from 21 million tons in 2001 to 25 million tons and 26.82 million tons in 2002 and 2003 respectively; and the price level is higher in line with increased production cost.

Cement Industry originated in India when the first plant commenced production in 1914 at Porbandar, Gujarat. The industry has since been growing at a steady pace, but in the initial stage, particularly during the period before Independence, the growth had been very slow. Since indigenous production was not sufficient to meet the entire domestic demand, the Government had to control its price and distribution statutorily. Large quantities of cement had to be imported for meeting the deficit.

The cement sector notably plays a critical role in the economic growth of the country and its journey towards conclusive growth. Cement is vital to the construction sector and all infrastructural projects. The construction sector alone constitutes 7 per cent of the country’s gross domestic product (GDP). The industry occupies an important place in the Indian economy because of its strong linkages to other sectors such as construction, transportation, coal and power. India is the second largest producer of quality cement in the world. The cement industry in India comprises 183 large cement plants and over 365 mini cement plants. Currently there are 40 players in the industry across the country. The cement industry in India is experiencing a boom on account of overall growth in the
Working and fixed capital are necessary financial requirement to run any industrial of service enterprise through their relative share and importance varies according to the nature of the industry. In heavy capital-intensive industries like Cement, fixed capital requirement is much more than working or floating funds. But over the years with inflation in the prices of inputs, the share of working capital in total assets has gone up and gradually problem of resources is becoming more serious than ever before.

Working capital = current assets – current liabilities

The working capital meets the short-term financial requirement of a business enterprise, it is the investment required for running day to day business. It is a Life blood and revenue center of the business. The proportion of working capital management components is important to the financial health of business from all industries. A popular measure of working Capital Management is the cash conversation cycle that is the time span between the expenditure for the purchase of raw material and the collection of sales of finished goods. The management of working capital may have both negative and positive impact of the firm profitability. Well maintained working capital will help to create good creditors image, avoid unwanted borrowing healthy government support etc. An effective working capital management will only help a firm to compete in the present global market.

Review of Literature

Profound research works have been conducted on working capital management in both private and public sectors industries in India and abroad. Many researchers have recognized the effect of optimal management of working capital on corporate performance. Indian literatures relevant to this paper, studied to find out the research gap and to have idea of the past work in the field, are presented below.

The working capital management is an important component of corporate finance because it directly affects the liquidity and profitability of the company. It is important due to many reasons. For one thing, the current assets of a typical manufacturing firm accounts for on an average more than 60 per cent its total assets. The excessive levels of working capital can easily result in a firm’s realizing a substandard return on investment. However, firms with less working capital may incur shortages and difficulties in maintaining smooth operations (Horne and Wachowicz, 2000). The efficient working capital management involves planning and controlling working capital in a manner that eliminates the risk of inability to meet due short term obligations on the one hand and avoid excessive investment in working capital on the other hand (Eljelly, 2004). Working Capital Management is a very sensitive area in the field of financial management (Joshi, 1994). It involves the decision of the amount and composition of current assets and the financing of these assets. Firms may have an optimal level of working capital that maximizes their value. Large inventory and a generous trade credit policy may lead to high sales. Larger inventory reduces the risk of a stock-out. Trade credit may stimulate sales because it allows customers to assess product quality before paying (Long, Malitz and Ravid, 1993, and Deloof and Jegers, 1996). The longer this time lag, the larger the investment in working capital (Deloof 2003). A longer cash conversion cycle might increase profitability because it leads to higher sales. (Deloof, 2003) discussed that most firms had a large amount of cash invested in working capital. It can therefore be expected that the way in which working capital is managed will have a significant impact on profitability of those firms. (Ghosh and Maji, 2003) in this paper made an attempt to examine the efficiency of working capital management of the Indian cement companies during 1992-2002. (Shin and Soenen, 1998) highlighted that efficient working capital management was very important for creating value for the shareholders. (Smith and Begemann 1997) emphasized that those who promoted working capital theory shared that profitability and liquidity comprised the salient goals of working capital management. The study of Ashraf Mohammad Salem Alrojoub and Ahmad Mustafa Altrawashdesh (2012) made an attempt to investigate the working capital management in cement units in Rajasthan on a sample of four companies, for a period of 5 years from 2006 – 2010.

Rai Sandeep Kumar and Dwivedi Shailesh K. (2011) in their study, stated that the Cement Industry in India is moment. Driven by a booming real estate sector, global demand and increased activity in his fracture development such as state and national highways, the cement industry has witnessed tremendous growth. The reality sector boomed but could not sustain for long and it collapsed because of the loan defaults. This situation spread like wild fiber and put the Indian economy in danger like the US economy. The US financial crises have affected many countries of the world and India is no exception to it. Because of these financial crises, Indian economy has lost more than 2% of GDP growth. Almost all sectors of the Indian economy have been affected by this crisis.

Chandrumarmangalam, P Govindasamy (2010) in their study have discussed the impact of leverage on the profitability of the firm. The relationship between the debt and equity ratio and earnings per share and how effectively the firm be financing. The leverage and profitability and growth are related and the leveraging impact on the profitability of the firm. Hill, Kelly, and Highfield. (2009) in their study named Net Operating Working Capital Behavior: A First look established a negative and a positive relationship between the various factor and the working capital ratio. It was established that working capital ratio had a positive operating cash flow and capital market access. It was also established that working capital ratio had a negative relationship with growth in sales, unexpected demand, rate of interest and financial difficulties.

Sureshchandra Kantilal Trivedi, studied 6 big cement companies of Gujarat for the period from 2000-01 to 2008-09. The working capital management and efficiencies and its current assets and liabilities components was analyzed and commented on the
trend of the components of working capital on the basis of ratios calculated for those six companies. Ashok Kumar Panigrahi, studied the inventory management practices and its impact on working capital efficiency in Indian cement companies. Top Indian companies’ data from 2001 to 2010 were used. Research findings indicated normal inverse relationship between inventory conversion period and firms’ profitability. He also found Gross Operating Profit to have negative relationship with financial debt ratio. The relationship between the firm size and GOP was positive and that between GOP and CA was negative.

Need of the Study
Though there are several studies made by various researchers, the purpose of the present study is to analyze the working capital management particularly the infrastructure industry, i.e., cement and find out the feasibility working capital in the light of better planning and control over the period of time. The problems of working capital management involve the issue of determining the optimum level of investment in each component of current assets, i.e. inventory, receivables, cash, and other short-term investment. The basic focus in working capital management should be to optimize the firm's investment. The experts in the field of financial management believe that working capital is one of the factors responsible for the low profitability in manufacturing sector. Therefore, better planning and control of working capital, or in other words, proper utilization of optimum quantity of working capital increases the earning power subject to the existence of operating margin.

Methodology
This study is based on secondary data which is collected from money control .com, annual reports of the company and various studies made available through library work. In this research we will see the different working capital management practices and its impact on profitability of Ambuja Cement company listed in the Bombay Stock Exchange for a period of five years from 2012–2016. Ratio analysis was chosen as a performance measurement and indicators in this analysis provide ratios for assessing the working capital management.

Objectives of the Study
(i) To study the working capital management of Ambuja cement company.
(ii) To evaluate the working capital management efficiency for the period 2012 - 2016.
(iii) To analyze the relationship between different components of working capital.
(iv) To find out the relationship between working capital efficiency and profitability.

Analysis of Liquidity Performance:
To analyze the liquidity performance current ratio, quick ratio and absolute ratios are calculated from the data collected in the annual reports of the selected company.

(i) Current Ratio
Current Ratio is a general and quick measure of liquidity of a firm. It represents the margin of safety or cushion available to the creditors. It is an index of the firm’s financial stability. It is also an index of technical solvency and an index of the strength of working capital. A ratio equal to or near 2: 1 is considered as a standard or normal or satisfactory. The idea of having doubled the current assets as compared to current liabilities is to provide for the delays and losses in the realization of current assets. It can be calculated as: Current Assets/Current Liabilities

Table-1: Current Ratio of Ambuja Cement during the period 2012-16.

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<tr>
<td>Current</td>
<td>1.21</td>
<td>1.27</td>
<td>1.26</td>
<td>1.41</td>
<td>0.91</td>
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<tr>
<td>Quick</td>
<td>0.95</td>
<td>1.00</td>
<td>1.03</td>
<td>1.17</td>
<td>0.66</td>
</tr>
<tr>
<td>Absolute</td>
<td>1.31</td>
<td>1.42</td>
<td>1.44</td>
<td>1.54</td>
<td>0.69</td>
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Source: Compiled from the annual reports of the select Company.

Table-1 presents the data on the liquidity performance of Ambuja cement during the period of study. It can be seen from the data in table-1 that the current ratio of almost all the year’s is by and large more than 1 but not near to the standard value i.e., 2:1. From the year 2012 it remained almost stable at around 1.2 till the year 2014. At 1.2 level of current ratio it can be said that the Ambuja cement is performing well by maintaining proper current assets to meet its current obligations. In the year 2015 the current ratio increased which is more than the previous year’s ratio, but not touching the ideal value of 2:1. In the recent years the current ratio of Ambuja cement is decreased. It can be interpreted that Ambuja cement has not been very strict in maintaining their current assets and in their current ratio.

(ii) Quick Ratio
Quick ratio is also known as liquid ratio or acid test ratio. This ratio measures the liquidity of a business by matching its cash and near cash current assets with its total liabilities. It helps us to determine whether a business would be able to pay off all its debts by using its most liquid assets (i.e. cash, marketable securities and accounts receivable). Ideal Ratio for acid test ratio is 1: 1 i.e., if business liquid assets are 100 percent of its current liabilities it is considered to be having fairly good current financial position. It can be measured as: Liquid (quick) assets / Current Liabilities.
From table-1, it can be said that the quick ratio of Ambuja cement for almost all the years is more or less maintain the ideal ratio of 1:1 except for the year 2016. In this year the ratio decreased to 0.66. Hence, it can be said that over all, the Ambuja cement has maintained an acceptable quick ratio during the period of study.

(iii) Absolute Quick Ratio
Absolute Quick ratio is the ratio of cash and cash equivalents of a company to its current liabilities. It is an extreme liquidity ratio since only cash and cash equivalents are compared with the current liabilities. It measures the ability of a business to repay its current liabilities by only using its cash and cash equivalents and nothing else. Since liquid ratio lays down very strict and exacting standard of liquidity, therefore, acceptable norm of this ratio is 50 percent. It means cash assets worth one half of the value of current liabilities are sufficient for satisfactory liquid position of a business.

Table-1 shows the value of liquid ratio of Ambuja cement for a period of 5 years. The values of the ratio of Ambuja Cement are at a higher side of the standard value of 0.5:1. In the year 2016 the value dropped to 0.69 but is still more than 0.5. On seeing all the three ratios i.e. current ratio, liquid ratio and Absolute Quick ratio of Ambuja Cement for last 5 years, it can be said that the company believe in keeping a very liberal working capital policy by keeping excess of current assets.

Working Capital Management Efficiency:
(i) Inventory Turnover Ratio
Inventory turnover ratio or Stock turnover ratio indicates the velocity with which stock of finished goods is sold i.e. replaced. Generally, it is expressed as number of times the average stocks has been “turned over” or rotate of during the year. High turnover suggests efficient inventory control, sound sales policies, trading in quality goods, reputation in the market, better competitive capacity and so on. Low turnover suggests the possibility of stock comprising of obsolete items, slow moving products, poor selling policy, over investment in stock etc. The ratio can be measured as: Cost of goods sold/Average inventory.

Table-2: Showing Turnover Ratios of Ambuja Cement

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<tbody>
<tr>
<td>Inventory Turnover</td>
<td>11.21</td>
<td>11.12</td>
<td>11.24</td>
<td>12.01</td>
<td>10.69</td>
</tr>
<tr>
<td>Working Capital Turnover</td>
<td>4.07</td>
<td>3.37</td>
<td>3.48</td>
<td>2.82</td>
<td>18.40</td>
</tr>
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Source: Compiled from the annual reports of the select Company.

Table-2 shows that Inventory Turnover Ratio of Ambuja Cement for 5 years has been consistent except for the year 2016 in which the value is the least at 10.69. Table shows that the value of the ratio lays between 11.21 and 12.01. The value of the ratio indicates that the company is not piling up too much stock in hand and also has a good selling policy.

(ii) Working Capital Turnover Ratio
This ratio represents the number of times the working capital is turned over in the course of year. The working capital turnover ratio measures the efficiency with which the working capital is being used by a firm. A high ratio indicates efficient utilization of working capital and a low ratio indicates otherwise. But a very high working capital turnover ratio may also mean lack of sufficient working capital which is not a good situation. It can be calculated as: Net Sales / Net Working Capital

Table-2 shows that the working capital turnover ratio of the select company is satisfactory. It indicates that the company is quite efficient in turning the working capital into sales. It can be seen that Ambuja Cement started with a working capital turnover ratio of 4.07 in the year 2012 that indicated that the company is operationally very efficient in maintain its current assets and current liabilities. As it moved ahead in year 2013 and further to 2015 the ratio started decreasing but still had a reasonably high value throughout these years. The ratio increased and reached a high of 18.40 in year 2016. Throughout these 5 years, the company has maintained a good working capital turnover ratio which indicates that the company has been efficient operationally.

Conclusion:
Cement industry is one of the most developing industries in India. Ambuja Cement is one of them. Its growth during past five years is eye catching; therefore, the investigator has undertaken a study on working capital management of Ambuja Cement. Current ratio of Ambuja Cement has registered constant increasing trends starting from 2012 which indicates that the company’s current assets condition is sound and strong. Inventory ratio also has continuously increased during the study period which indicates that stock executes fast during all this time which indicates its sound sales in the market. Mostly, all ratios registered upward and positive trend which indicates that company’s working capital position is strong, and its working capital system and policy works efficiently. Company is in the position to manage cash and liquidity well in this business.
References:


