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IMPACT ON WORKING CAPITAL MANAGEMENT AND PROFITABILITY

[1] Gayathri. P(Ph.D/2021/5191), And [2] Dr. Saravanan. D
[1] Ph.D Research Scholar, PG and Research Department of Commerce.,K.M.G College Of Arts & Science, Affilated to Thiruvalluvar University, Serkadu, Vellore 632115.Tamil Nadu, India.
gayathrisims@gmail.com
[2] Assistant Professor & Research Supervisor, PG and Research Department of Commerce.,K.M.G College Of Arts & Science, Affilated to Thiruvalluvar University, Serkadu, Vellore 632115.Tamil Nadu, India.

ABSTRACT

IMPACT ON WORKING CAPITAL AND PROFITABILITY AN OVERVIEW

Working capital is the difference between a company's current assets and its current liabilities. Current assets include cash, inventory, accounts receivable, and other assets that are expected to be converted into cash within one year. Current liabilities include accounts payable, short-term loans, and other obligations that are due within one year. Effective working capital management involves balancing the inflow and outflow of cash to ensure that a company has enough cash to cover its expenses and invest in growth opportunities.

One of the key ways that working capital management affects profitability is through its impact on cash flow. A company that manages its working capital effectively can ensure that it has enough cash on hand to cover its operating expenses and invest in growth opportunities, while also minimizing its financing costs.

INTRODUCTION

Working Capital Management (WCM) is essential for a Construction Private Limited Company as it helps to ensure the company has enough cash flow to cover its operational costs and capital investments while also maintaining profitability. WCM for a Construction Private Limited Company involves managing the company's current assets and liabilities effectively to ensure that it can meet its short-term financial obligations.

Finally, managing cash flow is a crucial aspect of WCM for a Construction Private Limited Company. Construction projects require significant upfront investment in materials, equipment, and labor, and the revenue from the project may not be received until much later. Therefore, effective cash flow management involves ensuring that the company has sufficient funds to cover its expenses, including payroll, materials, and equipment, while also maintaining adequate cash reserves.

In summary, effective WCM for a Construction Private Limited Company involves managing AR, inventory, AP, and cash flow effectively. By doing so, the company can ensure that it has the necessary funds to cover its expenses while also maintaining profitability and investing in future growth opportunities.

OBJECTIVES OF THE STUDY

1.Analyze the benefits of working capital provided by Pvt ltd to their employees:

2.Investigate the sources and uses of working capital:
3.Examine the liquidity position through various working capital related ratios:
4.Analyze the components of working capital such as receivables accounts, cash management, and inventory management

NEED OF THE STUDY

The study has been undertaken to assess the Working Capital on their benefits provided by Akshal Business Private Limited, and this study also helps to know the preferences and Working capital. The need for working capital arises due to the time gap between realization of cash from sales. Working capital is must for every business for purchasing construction materials, stores, inventories & etc and the following purposes.

Current Assets − Current Liabilities = Net Working Capital (NWC)

NET WORKING CAPITAL (PENMAN, 2013)

The net balance between a company's current assets and current liabilities is crucial for assessing its short-term financial stability. Net working capital (NWC) serves as an indicator of the company's ability to meet its short-term obligations and demonstrates its short-term survival strength.

VARIABLES IN WORKING CAPITAL MANAGEMENT

1 CASH CONVERSION CYCLE

The cash conversion cycle measures the time it takes to convert a company's investments in inventory and accounts receivable into cash. A shorter cash conversion cycle indicates more efficient working capital management and can lead to improved profitability.

Days Inventory Outstanding (DIO) = Inventory / (Cost of Goods Sold/365) Days Sales Outstanding (DSO) = Receivables / (Sales/365)

Days Payable Outstanding (DPO) = Payables / (Cost of Goods Sold/365)

DIO + DSO − DPO = CCC

(Figure 1)

2 OPERATING CASH FLOW

The net cash flow of a company is the sum of its incomes from operating, financing, and investing activities, as shown in Figure 3. Operating activities refer to the daily actions that are expected to generate the most income for a company, while income from finance and investments can be considered the use of excess capital. However, the use of finance and investment activities can also be strategic in driving development and growth. (Gilchrist & Himmelberg, 1995)

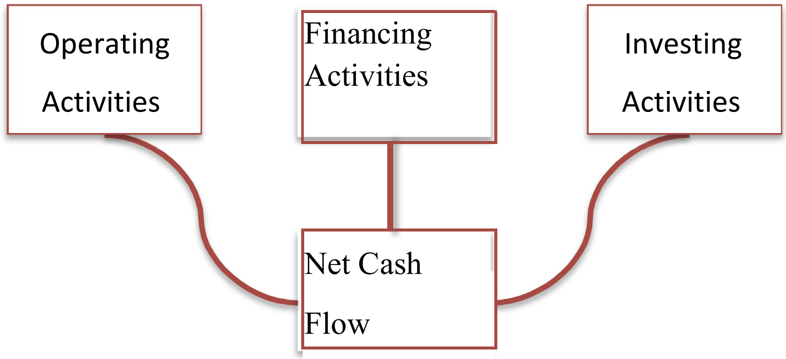

FIGURE 2: NET CASH FLOW (GILCHRIST & HIMMELBERG, 1995)

3 INVENTORY TURNOVER

Inventory turnover measures how quickly a company sells its inventory and replaces it with new inventory. A higher inventory turnover ratio indicates more efficient inventory management and can lead to improved profitability.

4 ACCOUNTS RECEIVABLE TURNOVER

Accounts receivable turnover measures how quickly a company collects payment from its customers. A higher accounts receivable turnover ratio indicates more efficient accounts receivable management and can lead to improved profitability.

5 ACCOUNTS PAYABLE TURNOVER

Accounts payable turnover measures how quickly a company pays its suppliers. A higher accounts payable turnover ratio indicates more efficient accounts payable management and can lead to improved profitability.

6 WORKING CAPITAL RATIO

The working capital ratio is the ratio of current assets to current liabilities. A higher working capital ratio indicates a company has more current assets to cover its current liabilities, which can indicate greater financial stability. However, an excessively high working capital ratio may indicate inefficient use of assets.

LITERATURE REVIEW

Kalyan C. Chejarla and P. Srinivasan (2021) Effective working capital management plays a vital role in businesses by ensuring a healthy cash flow, optimizing operational efficiency, and enhancing profitability (Chejarla & Srinivasan, 2021). The literature review conducted by Chejarla and Srinivasan explored the importance of managing current assets and liabilities to maximize short-term liquidity and drive long-term growth.

Ismaila Mohammed, Hira Nisar and Muhammad Naveed (2020) The literature demonstrates the critical influence of working capital management on firm performance, especially in emerging markets characterized by volatile cash flows and limited financing options. Existing studies acknowledge that effective management of working capital can significantly enhance firm performance within such contexts.

RESEARCH DESIGN

STATEMENT OF THE PROBLEM

- The Thesis aims to explore and explain the effects of shifting management attention on working capital efficiency and how companies manage working capital continuously. The study adopts an abductive approach, combining deductive and inductive reasoning, to conduct a flexible investigation into the chosen topic.
- The study aims to understand the effects of shifting management attention on working capital efficiency and how companies manage working capital over time. It does not seek to establish definitive truths or create new theories but rather aims to contribute to existing knowledge and understanding of organizational behaviour in the context of working capital management.

CURRENT RATIO: CURRENT ASSETS

Can be converted in to cash immediately without a loss of value; Inventories are considered to be less liquid. Because inventories normally require some time for realizing into cash. This ratio is also known as acid-test ratio. The standard quick ratio is 1:1. Is considered satisfactory.

Quick Ratio = Quick Assets (current assets - Inventory)

Current Liabilities

INTERPRETATION:

During the Year 2020- 2021 it increases 0.87, and in 2021-22 quick ratio was 0.65 due to increase in quick assets. The quick ratio is above the standard ratio i.e., 1:1. Hence it shows that the liquidity position of the company is adequate.

ABSOLUTE LIQUID RATIO:

Absolute liquid ratio may be defined as the relationship between Absolute liquid assets and current liabilities. Absolute liquid assets include cash in hand and cash at bank. The standard ratio is 0.5:

Absolute Liquidity Ratio = Cash & Bank Balance

Current Liabilities

INTERPRETATION:

It shows the Absolute liquidity ratio increases every year but it is below the standard ratio. In the year 2021-2022 the Absolute liquidity ratio has increases 0.27. Hence it shows that the liquidity position of the company is satisfactory.

INVENTORY TURNOVER RATIO:

Inventory turnover ratio is the ratio, which indicates the number of times the stock is turned over i.e., sold during the year. This measures the efficiency of the sales and stock levels of a company. A high ratio means high sales, fast stock turnover and a low stock level. A low stock turnover ratio means the business is slowing down or with a high stock level.

$$\textbf{Inventory Turnover Ratio} = \frac{\textbf{Net Sales}}{\textbf{Closing Inventory}}$$

Year	Net Sales	Closing inventory	Inventory Turnover ratio
2020- 2021	12,69,48,966.26	3,52,44,432.00	3.60
2021-2022	11,89,03,645.73	3,55,52,844.00	3.34

INTERPRETATION:

In the year 2020- 2021 and 2021- 2022 to 3.60 times and 3.34 times respectively. This shows the company has decrease in sales.

INVENTORY HOLDING PERIOD:-

This period measures the average time taken for clearing the stocks. It indicates that how many days' inventories take to convert from raw material to finished goods.

$$\textbf{Inventory Holding Period} = \frac{\textbf{Days in a year}}{\textbf{Inventory turnover ratio}}$$

Year	Days in a Year	Inventory Turnover Ratio	Inventory Holding Period
2020- 2021	365	3.60 Times	101.33 Days
2021-2022	365	3.34 Times	109.14 Days

INTERPRETATION:

Inventory holding period fluctuating over the years there was a subsequent decrease in the year 2020- 2021 and 2021- 2022 to 101.33 days and 109.14 days respectively. This shows the company is minimizing these inventory-holding days thereby to increase the sales.

DEBTORS / ACCOUNTS RECEIVABLES TURNOVER RATIO:-

Debtor's turnover ratio indicates the speed of debt collection of the firm. This ratio computes the number of times debtors (receivables) has been turned over during the particular period.

$$\textbf{Debtors Turnover Ratio} = \frac{\textbf{Net Sales}}{\textbf{Average Debtors}}$$

Year	Net Sales	Average Debtors	Debtors Turnover Ratio
2020- 2021	12,69,48,966.26	3,64,24,244.66	3.49 Times
2021-2022	11,89,03,645.73	3,72,76,553.06	3.19 Times

INTERPRETATION:

It is clear that debtor turnover ratio fluctuating over the years. It decreased to 3.49 times and 3.19 Times in the year 2020- 2021 and 2021- 2022 respectively. This shows the company is not collecting debt rapidly.

DEBTORS COLLECTION PERIOD :-

Debtors collection period measures the quality of debtors since it measures the rapidity or the slowness with which money is collected from them a shorter collection period implies prompt payment by debtors. It reduces the chances of bad debts. A longer collection period implies too liberal and inefficient credit collection performance.

$$\textbf{Average Collection Period} = \frac{\textbf{Days in a Year}}{\textbf{Debtors Turnover Ratio}}$$

Year	Days in a Year	Debtors Turnover Ratio	Debtors Collection Period
2020- 2021	**365**	**3.49 Times**	**104.73 Days**
2021-2022	**365**	**3.19 Times**	**114.43 Days**

INTERPRETATION:

Debt collection period changing over the years. There was a subsequent increase in the year 2020-2021 and 2021- 2022 to 104.73 days and 114.43 days respectively.This shows the inefficient credit collection performance of the company

CREDITORS PAYMENT PERIOD:-

The Creditors Payment Period represents the average number of days taken by the firm to pay the creditors and other bills payables.

$$\textbf{Average Payment Period} = \frac{\textbf{Days in a Year}}{\textbf{Creditors Turnover Ratio}}$$

Year	Days in a Year	Creditors Turnover Ratio	Average Payment Period
2020- 2021	365	2.29 Times	159.57Days
2021-2022	365	3.25 Times	112.36Days

INTERPRETATION:

Average payment period changing over the years 2020- 2021 it also increased to 118.34 days and 159.57 days respectively. In the year 2020- 2021 it is same as compared to 2021- 2022. It indicates that the company has taken the steps to prompt payment to the creditors.

WORKING CAPITAL TURNOVER RATIO:-

This ratio indicates the number of times the working capital is turned over in the course of the year. This ratio measures the efficiency with which the working capital is used by the firm. A higher ratio indicates efficient utilization of working capital and a low ratio indicates otherwise. But a very high working capital turnover is not a good situation for any firm.

$$\textbf{Working Capital Turnover Ratio} = \frac{\textbf{Net Sales}}{\textbf{Net Working Capital}}$$

Year	Net Sales	Net Working Capital	WCTR
2020- 2021	12,69,48,966.26	2,48,16,209.58	5.12 Times
2021-2022	11,89,03,645.73	1,89,38,701.50	6.28 Times

INTERPRETATION:

But there is also increases in the year 2020- 2021 and 2021- 2022 to 5.12 and 6.28 times respectively. This shows the company is utilizing working capital effectively.

TABLE 1: STATEMENT OF CHANGES IN WORKING CAPITAL FOR THE YEAR 2020-2021

Particulars	As on 31-03-2020	As on 31-03-2021	Effect on working capital	
			Increase	**Decrease**
CURRENT ASSETS				
Stock in hand & WIP	3,30,63,370.00	3,52,44,432.00	21,81,062.00	-
Sundry debtors	2,51,08,295.01	4,77,40,194.31	2,26,31,899.30	-
Cash & Bank balance	1,71,02,617.69	2,13,94,430.08	42,91,812.39	-
Other current assets	-	10,03,707.48	10,03,707.48	-
(A)Total Current Assets **CURRENT LIABILITIES**	**7,52,74,282.70**	**10,53,82,763.87**		
Sundry creditors	4,11,47,523.31	4,84,25,233.79	-	72,77,710.48
Bank overdraft	2,29,63,697.14	3,21,41,320.50	-	91,77,623.36
(B)Total Current Liabilities	**6,41,11,220.45**	**8,05,66,554.29**		
(A)-(B) Net Working Capital	**1,11,63,062.25**	**2,48,16,209.58**		
Increase in Working Capital	**1,36,53,147.33**			**1,36,53,147.33**

TABLE 2: STATEMENT OF CHANGES IN WORKING CAPITAL FOR THE YEAR 2021-2022

Particulars	As on 31-03-2021	As on 31-03-2022	Effect on working capital	
			Increase	Decrease
CURRENT ASSETS				
Stock in hand & WIP	3,52,44,432.00	3,55,52,844.00	3,08,412.00	-
Sundry debtors	4,77,40,194.31	2,68,12,911.80	-	2,09,27,282.51
Cash & Bank balance	2,13,94,430.08	7,41,492.00	-	2,06,52,938.08
Other current assets	10,03,707.48	31,66,646.00	21,62,938.52	-
(A)Total Current Assets **CURRENT LIABILITIES**	**10,53,82,763.87**	**6,62,73,893.80**		
Sundry creditors	4,84,25,233.79	1,59,25,678.30	3,24,99,555.49	-
Bank overdraft	3,21,41,320.50	3,14,09,514.00	7,31,806.50	-
(B)Total Current Liabilities	**8,05,66,554.29**	**4,73,35,192.30**		
(A)-(B) Net Working Capital	**2,48,16,209.58**	**1,89,38,701.50**		
Decrease in Working Capital	**-58,77,508.08**			**-58,77,508.08**

INTERPRETATION:

In the above table, it is seen that during the year 2020- 2021 and 2021- 2022 there was huge net increase in working capital by Rs 58,77,508.08 As Compare to 2019-20 and 2020- 2021. This is because

There is Increase in current assets such as Inventories by Rs 3,08,412.00 and decrease in Sundry debtors by Rs 2,09,27,282.51, Cash & Bank balance by Rs 2,06,52,938.08 and other current assets by Rs 21,62,938.52.

There is Increase in current liabilities such as Sundry creditors by Rs 3,24,99,555.49, Bank overdraft by Rs 7,31,806.50.

SUMMARY OF FINDINGS

The analysis of M/s. Akshal Business Private Limited's net working capital and various financial ratios provides valuable insights into the company's financial performance and working capital management.

During the years of study, the net working capital of the company exhibited fluctuations, experiencing both increases and decreases. This variability may be attributed to the impact of the COVID-19 pandemic, which likely affected the company's operations and financial stability. It is important for Akshal Business Private Limited to closely monitor and manage its working capital to mitigate the challenges posed by external factors.

The current ratio, which measures the company's ability to meet short-term obligations, showed a satisfactory and consistent upward trend throughout the study period. This indicates that the company had sufficient current assets to cover its current liabilities. However, it is essential for the company to maintain this positive trend and ensure its liquidity remains strong.

CONCLUSION

The analysis of Akshal Business Private Limited's working capital management and profitability reveals some important insights.

Firstly, there is a clear indication of a reducing trend in both working capital and profitability. This highlights the significant impact that poor working capital management can have on the company's profitability, and vice versa. It is imperative for the company to address this issue promptly and implement measures to improve the efficiency of its operations and working capital management. By doing so, Akshal Business Private Limited can enhance its profitability and financial stability.

Secondly, the current and quick ratios of the company are not up to satisfactory levels. This suggests that the company's cash conversion cycle may need improvement. It is important to consider that the period of study coincided with the COVID-19 pandemic and the subsequent years, which likely had an adverse impact on the company's business operations. Therefore, Akshal Business Private Limited should take necessary measures to optimize its cash flow and liquidity management, considering the unique circumstances faced during this period.

In conclusion, Akshal Business Private Limited must undertake comprehensive steps to improve its working capital management and profitability. By implementing effective strategies to enhance operational efficiency, optimize cash flow, and improve resource utilization, the company can strengthen its financial position and pave the way for sustainable growth and success in the construction industry.

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