

# Working Capital Management in Power Distribution Companies in Andhra Pradesh

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## ABSTRACT

Therefore, adequate working capital is required for uninterrupted of organization activities. In this paper an attempt has been made to the study the Liquidity position, structure of working capital and financing of working capital. Efficient management of working capital is important for the success of enterprise, whereas inefficient management of working capital may be caused due to various problems such as reducing of liquidity position, losing of profits and utility that leads to winding up of company. Current ratio of two power distribution companies is less than standard norm, indicating that liquidity position is not satisfactory. It is observed that inventory turnover ratio of two power distribution companies is high and inventory holding period is low, impels that inefficiency in conversion of stock in to sales. The working capital turnover ratio of both power distribution companies is low, indicating over investment current assets.

## 1. Introduction

There are two concepts of working capital. Gross Working Capital and Net Working Capital. The term gross working capital refers to total current assets<sup>1</sup>. In other words, gross working capital means the current assets which represent the proportion of investments that circulates from one firm to another in the ordinary course of business. Temporary or variable working capital is the amount of working capital which is required to meet the seasonal demands and some special exigencies. Variable working capital can be further classified into seasonal working capital and special working capital. Generally, firms have to maintain additional working capital to meet the special and seasonal needs. The working capital required to meet the seasonal needs is called seasonal working capital. Working capital which is required to meet special contingencies like launching of extensive marketing, campaigns for conducting research etc. is called special working capital. Every firm needs working capital irrespective of its nature. Manufacturing concern require more working capital than a trading concern. Efficient management of working capital is important for the success of enterprise, whereas inefficient management of working capital may be caused due to various problems such as reducing of liquidity position, losing of profits and utility that leads to winding up of company. Therefore, adequate working capital is required for uninterrupted of organization activities. In this paper an attempt has been made to the study the Liquidity position, structure of working capital and financing of working capital in Southern Power Distribution Company of Andhra Pradesh Limited and Eastern Power Distribution Company of Andhra Pradesh Limited for the period 2007-08 to 2016-17.

## 2. Analysis of short term solvency position

The term, short term solvency, refers to liquidity capacity of the firm. That means the firms capacity of conversion of current assets in to cash within a short period to meet its short term obligations (current liabilities). Maintaining of liquidity by every firm is an important element to meet its short term

obligations. Adequate liquidity position is to be maintained by every firm. Otherwise the firm loses confidence of creditors that leads to loss of credit facilities. The following are the important ratios used to measure the liquidity position in the power distribution companies.

1. Current Ratio
2. Quick Ratio

### 2.1 Current Ratio

The standard norm of current ratio is 2:1 that means the firm had Rs.2 worth of current assets against a current obligation of Re.1 providing sufficient safety margin to creditors. High current ratio indicates the firm's capacity to repay its current obligations within a short period. On the other hand, low current ratio indicates firm's inability in meeting its current liabilities. Therefore, the firm must maintain a sufficient level of current ratio.

The current ratio of the Southern Power Distribution Company of Andhra Pradesh Limited varied between 0.35 per cent and 2.10 per cent. The average current ratio for the study period of 10 years is stood at 1.16:1, it is below the standard norm of 2:1, indicates the firm's liquidity position is poor. Hence, the firm's capacity towards payment of current liabilities is not satisfactory. There is a moderate positive correlation (0.59) between Current Assets and Current Liabilities for the study period.

The current ratio the Eastern Power Distribution Company of Andhra Pradesh Limited varies between 0.74 per cent to 2.15 per cent. The average current ratio is 1.56:1, which is less than 2, indicates the liquidity position of the company is weak. There is a positive relationship between current assets and current liabilities and the 'r' is 0.65.

### 2.2 Quick Ratio

This ratio explains the relationship between the quick assets and current liabilities. The term quick assets means qualitative current assets ie., the assets which can be

converted in to cash immediately without loss of value. The word quick assets mean current assets minus Inventory and prepaid expenses. The standard norm of quick ratio is 1:1. The lower this ratio the greater the firm's difficulty to meet its short term obligation which implies non co-operation of creditors in future.

The quick ratio of the Southern Power Distribution Company of Andhra Pradesh Limited varies from 0.36:1 to 2.04:1. The average quick ratio (1.12) is more than standard norm of 1:1. The liquidity position, by and large, is satisfactory during the study period, implies that investment in inventory is the major component of current assets.

The quick ratio of the Eastern Power Distribution Company of Andhra Pradesh Limited varies between 0.72:1 and 2.48:1. The quick ratio of the company is more than standard norm for the period from 2007-08 to 2011-12 and less than standard norm for the period 2012-13 to 2016-17. Therefore, the short term liquidity position of the Eastern Power Distribution Company of Andhra Pradesh Limited by and Lange is satisfactory for the study period.

### 3. Structure of working capital

The size and the liquidity analysis revealed that the Southern Power Distribution Company of Andhra Pradesh Limited and Eastern Power Distribution Company of Andhra Pradesh Limited invested huge amount on current assets during the study period and thereby suffered on the liquidity front as indicated by lower current ratio and quick ratio. Therefore, the study is focused on composition of current assets (popularly known as structure of working capital) in power distribution companies. The analysis reveals the share of qualitative current assets and non-qualitative current assets of the Southern Power Distribution Company of Andhra Pradesh Limited and the Eastern Power Distribution Company of Andhra Pradesh Limited.

It is observed that other current assets and debtors are playing a dominant role in the total current assets of the Southern Power Distribution Company of Andhra Pradesh Limited. On an average, the company's proportion of other current assets to its current assets stood at 51.17 per cent. Debtors occupied next important role and it contributes 39.31 per cent towards current assets. The share of cash is having lesser proportion which had an average of 9.40 per cent. The compound growth rates for cash, debtors and total current assets are 9.05 per cent, 39.31 per cent and 10.58 per cent respectively. Negative growth observed in the case of inventory and other current assets.

In the case of Eastern Power Distribution Company of Andhra Pradesh Limited the average Proportion of other current assets to the total current assets was 56.61 per cent for the study period. Debtors occupied an important role it also contributes around 30.99 per cent towards current assets. Its proportion to total current assets varies between 16.04 per cent and 71.5 per cent during the study period. Other current assets are also playing an important role. Their proportion to current assets varies between 11.2 per cent to 52.48 per cent. The

proportion of cash is around 5.62 per cent on an average during the study period.

### 4. Adequacy and efficiency analysis of working capital

As the working capital constitute a dominant proportion of total assets in the power distribution companies, it would be necessary to check how far the present size is adequate, inadequate or excessive in order to judge the efforts of the management in maintaining optimum level of investment in working capital. There is no hard and fast rule to measure the adequacy of the working capital. However, some ratios, namely, turnover ratios are used to the adequacy.

### 5. Working capital turnover ratios

Working capital turnover ratios measures the velocity of conversion of current assets in to another. The higher the current ratio the higher will be the efficiency in working capital management and vice versa. To determine the efficiency of the management in terms of working capital management in power distribution companies, some important turnover ratios like inventory turnover ratio, debtor's turnover ratio and working capital turnover ratio have been used.

#### 5.1 Inventory turnover ratio

In the case of manufacturing concerns the level of inventory depends upon production which ultimately depends upon sales. However, for computation of inventory turnover ratio average inventory and cost of goods sold are considered as an appropriate base. The inventory turnover ratio indicates how many times the inventory is converted into sales and thereby reflects the efficiency of management in utilizing inventory. This ratio explains the relationship between the cost of goods sold and the average inventory of the given period.

The inventory turnover ratio of Southern Power Distribution Company of Andhra Pradesh Limited increased from 30.76 times in 2007-08 to 216.65 times in 2016-17. The average inventory turnover ratio stood at 79.49 times indicates inefficiency of the management in terms of conversion of inventory in to sales. With respect to the inventory holding period the average inventory holding period is 6.20 days. The inventory holding period has been decreasing from 2007-08 to 2016-17.

The inventory turnover ratio Eastern Power Distribution Company of Andhra Pradesh Limited showing fluctuating trend for the study period. The average inventory turnover ratio stood at 65.46 times. It shows high ratio during 2010-11 (i.e., 101.25 times) and very minimum during 2007-08 (38.06 times). The inventory holding period is on an average 6.13 days. Low inventory holding period and high inventory turnover ratio implies that the inventory management is not satisfactory.

#### 5.2 Debtors Turnover Ratio

Debtors turnover ratio is used to measure the relationship between the credit sales and realization of debtors. This ratio helps to test whether the net credit sales of a firm match its recorded trade debtors and thereby it indicates how many times the debtors are converted into cash. The quantum of trade debtors is relay on the volume of credit sales made by

the firm. Credit policy followed by the firm is also having influence on debtors turnover ratio.

The Debtors turnover ratios of Southern Power Distribution Company of Andhra Pradesh Limited showing fluctuation trend during the study period. The volume of sales are showing increasing trend during the study period. Debtors turnover ratio for the study period varies between 1.91 times and 16.72 times. The average Debtors turnover ratio for the study period is around 7.86 times. The Average Debt collection period varies between 22 days and 192 days. The Average collection for period the study period stood at 79 day it is not satisfactory impels that poor collections from debtors.

In the case of Eastern Power Distribution Company of Andhra Pradesh Limited debtors turnover ratio varies between 1.67 and 9.13 times, and the average debtors turnover ratio for the study period is 5.48 times. The debt collection period varies between 40 day and 218 days and the average debt collection period is 98 days. Therefore, the credit policy of the company is not good.

### 5.3 Working Capital Turnover Ratio

This ratio explains the relationship between the working capital and sales. The amount of working capital tends to generate sufficient amount of sales. The relationship of working capital and sales should be positive. It indicates the efficiency

with which the working capital is used. The efficiency with which the working capital is used to generate sales can be judged with the help of working capital turnover ratio.

The working capital turnover ratio of Southern Power Distribution Company of Andhra Pradesh Limited is more than 1 time, except 3 years from 2009-10 to 2011-12. The average working capital turnover ratio is stood at 1.68 times. The working capital turnover ratio varies between 0.89 times and 2.75 times. This indicates working capital was not adequate and sales volume was gone up in terms of working capital.

In the case of Eastern Power Distribution Company, the working capital turnover ratio varies between 0.84 times and 2.61 times for the study period. The working capital turnover ratio is more than 1 time, except for 2010-11 and 2011-12. The average working capital turnover ratio stood at 1.46 times.

## 6. Conclusion

Current ratio of two power distribution companies is less than standard norm, indicating that liquidity position is not satisfactory. It is observed that inventory turnover ratio of two power distribution companies is high and inventory holding period is low, impels that inefficiency in conversion of stock in to sales. The working capital turnover ratio of both power distribution companies is low, indicating over investment current assets.

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