

Size and Components of Working Capital in selected Spinning Mills in South India

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ABSTRACT

In a wide ranging study of southern Indian spinning mills, it is identified that the growth and development of the industry has a importance bearing on the overall development of the Indian economy. There is high growth potential which is supported by statistics. The strengths of the textile industry and its commendable export performance in the last decade are distinguished. Profitability, however, has been very low, though greater opportunities are expected under the WTO regime. The potentially feasible mills need to be supported. Gross working capital represents the commitment of funds in various components of currents, such as cash, short term securities receivables, pre- payments, short term loans and advances in inventories. In this paper an attempt has been made to study the size and components of working capital in selected spinning mills in South India.

1. Introduction

Gross working capital represents the commitment of funds in various components of current assets, such as cash, short-term securities receivables, pre-payments, short-term loans and advances and inventories. They are limited by accounting convention to those that are expected to be converted into cash within a year. Current assets may also be conceived as those assets which in the normal course of business can be converted into cash within a short time span normally one year, without undergoing diminution of value and without disrupting the organization. In the words of Adam Smith "the goods of the merchant yield him no revenue or profit unless he sells them for money, and the money yields him a little till it is again exchanged for goods. His capital is continuously going from him in one shape and returning to him in another shape, and it is only by means of such capital, therefore, very properly be called as 'circulating capital'.

It is obvious that Gross working capital management deals with the problems of managing individual current assets in the day to day business operations. Generally these assets constitutes more than half of the total assets of a concern. In Cotton Textile Industry, current assets constitute nearly 60-70 per cent of investment. The management of working capital helps the financial executive in evaluating various existing or proposed financial constraints and financial offerings. More over, the management of current assets consumes a lot of time and energy and demand greater efforts to man it profitably. The level of current assets decides the risk and return of a concern. As the size of current assets increases both risk and return would decrease and vice-versa. Current assets are the assets which management expects to keep active and investment in them is relatively volatile. In a going concern these assets flow regularly and continuously out of cash and realize bank into cash. Every concern aims at speeding this conversion process, as higher conversion rate involves lesser investment in current assets and results in lesser working capital requirement.

The current assets by its nature are generally controllable segment of investment, particularly in a manufacturing concern. And any amount of effort to optimize the investment in various components of these assets would certainly ensure savings on avoidable ouys and eventually lead to profitability. Every concern desires to have an optimum investment on assets as it maximizes the return and minimizes the risk. Failing to do so, it has a deleterious impact on the concern, resulting in an uneconomic business operations leading to losses and it would buffet the liquidity position of the concern also. It is the dire need to bring balance between liquidity and profitability.

2. Review of Literature

Mine Aysen Doyran and Juan Delacruz (2011) suggested that Latin America, should take the presence from the Asian textile industry experience. This paper examines recent statistics in US textile and clothing trade with selected Latin American and Asian economies, comparing data on textile exports from the top 10 suppliers between 1995 and 2003. It evaluates the initial effects of the Agreement on Textiles and Clothing (ATC) of 1995, which provided for a 10-year quota phase-out process for WTO member countries. Since its accession into WTO, China has replaced Mexico as the top supplier of goods to the US. In addition, a brief comparison with other international experience of emerging economies is provided in order to elucidate the relevance of the textile industry in the region and world economy. This empirical work can be the starting point for policy makers to design long-term policies that are needed for Latin America to compete successfully in the US market and promote the restructuring of clothing and textile production at the country level.

Quayyum (2012) investigate the relationship between working capital management and profitability of manufacturing companies. In this study, he has selected the companies enlisted with the DSE and the analysis covers a time period from year2005 to 2007. The study emphasized to figure out if there is statistically significant relationship between the

profitability and working capital management and help explain the necessity of firms optimizing their level of working capital management efficiency and in that way management takes productive actions to maximize their profitability. The result of this study clearly has showed that except for food industry all other selected industries have a significant level of relationship between the profitability indices and various working capital components. This paper also has showed that the significance level of relationship varies from industry to industry.

R. Krishnakumar(2013) in their paper on "A Study of Managerial Efficiency Ratios of Selected Indian Textile Companies" the efficient performance is the primary condition for development of any industry, which can help the industrial growth in an economy. In a country with a huge population like India, industry can transform the entire spectrum of economic activity from Textile industry through efficient use of resources. The labour intensive Textile technology industry may be a better strategy for India the textile industry can increase the employment in a heavy populated Indian Economy. However, financial performance has also to be considered for industry to flourish and nourish the people. In this paper, an endeavor has been made to analyze the financial performance of some selected textile companies in India.

Meenakshi Anand (2014) in their work on 'A Study of Financial Analysis in Textile Sector' the textile industry of India plays a substantive role in the economy. This is one of the largest industries in India in terms of employment generation, and earning foreign exchange. The paper focuses on the financial strength of the textile sector in India. And to know that up to what extent textile sector has used their available resources effectively. For this purpose profitability, liquidity and solvency position of textile companies has examined. In this paper comparative ratio analysis technique has used to know the financial soundness of textile companies. The result shows the profitability margins has slightly different due to volatile textiles market and volatility in raw material prices. The liquidity and solvency position is almost same in all the textile companies.

3. Statement of the problem

Indian spinning industry is one of the oldest and largest segment of the country's industrial sector and occupies the pride of place in Indian industry. The Indian cotton textile industry provides employment to nearly one million, Besides it provides indirect employment to several million engaged in cotton cultivation and associated functions like ginning and pressing, seed cotton marketing apparel production, internal and external trade in raw cotton, yarn and fabrics, cotton seed oil industry etc. Further, it also serves few industries like those engaged in production of fertilizers, pesticides and other agro-chemicals, dyes and other textile finishing chemicals. It is also a major source of foreign exchequer and has gained a unique status in the international market.

The handlooms and power looms constituting the decentralized sector, on one hand, and private mills, Government managed National Textile Corporation (NTC) mills and the co-operative mills comprising the organized sector, on the other, are the two structural components of

Indian cotton textile industry. Keeping in view its contribution to the national economy, the Government has taken the initiative and formulated certain package of measures and policies to boost its growth. Despite several measures taken by the Government, the industry has been suffering from multifarious problems like shortage of raw materials, high production cost, insufficient working capital, mounting sickness, lack of scope for expansion and modernization, declining exports and high levels of taxation.

The profit margin in the textile industry is very low when compared to that of other major industries. The very low level of profit margins and the large inter year variation in the costs of spinning mills, and new challenges to the already strained and inadequate working capital. Inadequate working capital forces the units to default in payment to creditors on schedule, not to purchase in time and purchase in inconvenient lots at a high cost, low inventory turnover, idle machine capacity because of interruptions and like. The aforesaid facts reveal that the Cotton Textile Industry in general and the Spinning mills in particular are under serious financial strain, particularly in the matter of working capital. Efficient management of meager working capital can improve the financial performance. Hence, the present study aim at an in depth study of size and components of working capital in select Spinning mills in South India.

4. Research Objectives

1. To study the size of current assets in select spinning mills;
2. To analyze the components of working capital in select spinning mills;
3. To examine the structure of working capital.

5. Scope and Coverage

The total spinning mills working in south india are 481. The listed mills from the sector at 10 percent sample has been drawn for the present study. Following are the 10 select Spinning Mills in South India.

1. Aditya Spinners, Srikalahasti, Andhra Pradesh
2. Kallam Spinning Mills, Guntur, Andhra Pradesh
3. Suryaamba Spinning Mills, Secunderabad, Telangana
4. Suryalata Spinning Mills, Secunderabad, Telangana
5. Suryavanshi Spinning Mills, Secunderabad, Telangana
6. Amarjothi Spinning Mills, Tiruppur, Tamilnadu
7. Gem Spinners India, Chennai, Tamilnadu
8. Kandagiri Spinning Mills, Salem, Tamilnadu
9. Sambandam Spinning Mills, Salem, Tamilnadu
10. Pasari Spinning Mills, Karnataka

6. Data Base

The data have been collected from both primary and secondary sources. The primary data have been drawn from the sample units with the help of a pre-tested schedule administered to the management of the spinning mills to elicit first hand information.

Secondary data include published reports viz, Reserve Bank of India Bulletins, Bombay; Financial performance of companies, Industrial Credit and Investment Corporation of India, Bombay; Reports of Andhra Pradesh Industrial Development Corporation, Hyderabad; Hand-book of Statistics on Cotton Textile Industry, The Indian Cotton Mills Federation, Bombay; Reports of The South India Textile Research Association, (SITRA) Coimbatore.

In addition, the other major sources of data are: Institute for Financial Management and Research (IFMR), Madras and Institute of Public Enterprises (IPE), Hyderabad. Further, various publications, journals in the sphere of industry and finance were extensively used. Published financial statements and annual reports of the sample spinning mills were collected to analyse the data.

In addition to these, several structured and unstructured interviews have also been conducted with experts on the subject and persons who are connected directly or indirectly with the functioning of spinning mills in South India.

7. Components of gross working capital

An outline of the elements of gross working capital will provide a greater insight into the components of current assets and they are discussed below.

7.1. Inventory

Inventory is a physical stock of goods stored for the smooth operations of the business and it accounts for major portion of gross working capital. Inventory may be in the form of raw material, work-in-process, finished goods, goods in transit, and in the warehouse ready for sale. It acts as a buffer between a supplier who generally supplies material in large amounts at a steady rate and the consumer without which the organization may be buffeted adversely.

Managing inventory basically involves balancing between the carrying cost and loss arising out of reduced sales due to an interrupted preproduction programme. An inventory maintained at a higher level leads to higher interest and storage costs and a low level of inventory, on the other hand, may result in frequent interruptions in the production process resulting in underutilization of production capacity and uneconomic sales volume. Further, the larger the amount of investment locked up on inventory, higher is the cost involved and adversely affecting the profitability of a concern and it keeps the scarce resources idle which could be utilized elsewhere productively and vice-versa. The situations where in the organization having exiguous and heavy amount of investment on inventory are too dangerous and what is needed is having an optimum investment on inventory which certainly minimize the cost and maximize the returns. Thus it requires a careful attention to be paid in managing inventory.

7.2. Accounts receivable

In any manufacturing and commercial firms accounts-receivable generally represent credit granted to their customers. The size of investment in debtors depends upon the credit and collection policies of the firm and industry in

general. It involves to bring trade-off between the gains arising out of incremental sales due to the liberal credit facilities offered by the firm on the one hand, and the additional cost of realizing these debts on the other. Liberal credit policies involve the cost of collection of debts, interest charges and the incidence of bad debts. Similarly, the stringent credit policy results in reduction of sales volume, as some customers may go to competitors who were offering more liberal terms, which affects profitability adversely.

Apart from deterring the credit policy of a firm, the management of debtors also requires an in-depth analysis of risk associated with grant of credit to various parties. A vigorous follow up of debtors and prompt credit collection policy is also an integral part of the management of sundry debtors.

7.3. Short-term Investments

When a firm has surplus cash balances, it would invest it in the short-term securities which are readily marketable and easily convertible into cash within a short span of time. It would generate some return on the surplus cash, thereby augment the profits without affecting liquidity.

7.4. Cash and Bank Balances

Cash is the most liquid and vital component of all the assets of a company, as every transaction results either in an inflow or outflow of cash. A financial manager has to meet the needs of cash well in advance. This would include funds for discharging firm's obligations promptly and something more than maintaining safe cash balances.

Since cash is the least productive and most liquid asset, any excess or shortage in the level of cash is too unwanted and it should be avoided. Excessive cash balances would tend to bring down profitability, in contrast, a cash shortage may lead to more serious situation of disrupting the operations of the firm. In a nutshell, an optimum amount of cash is to be maintained and provide it whenever the need arises. Which in fact keeps up the liquidity and profitability intact.

7.5. Other current assets

These assets include pre-payments, loans and advances, interest accrued, taxes paid in advance and so on.

8. Size of current assets

The size of current assets has been on the increase during the period 2008-09 to 2017-18. The average of current assets (34.18 crores) is low in the initial period of study and it raised up to 53.61 crores at the end of the period. The amount of current assets varied widely within the sample spinning mills. It varied from 1.31 crores to 6.29 crores for Aditya, 32.51 crores to 176.77 crores for Kallam, 19.06 crores to 36.84 for Suryamba, 34.59 crores to 61.20 crores for Suryalata, 52.32 crores to 9.14 crores for Suryavanshi, 52.26 crores to 116.70 for Amarjothi, 50.10 crores to 1.05 crores for Gem, 37.14 crores to 32.39 crores for Kandagiri, 56.64 crores to 92.75 crores for sambandam, 5.29 crores to 0.01 crores for Pasari. The amount of investment in current assets in Aditya, Kallam, Suryaamba, Suryalata, Amarjothi and Sambandam have

shown an increasing trend. In Surya vanshi, Gem, Kandagiri and Pasari have shown an decreasing trend.

9. Composition of gross working capital

After considering the size of working capital in the select sample mills, it is imperative to study the importance of various components of working capital relative to total current assets. Each components of working capital to total current assets during the study period current assets include inventories, receivables, cash and cash equivalence and other current assets.

The inventory constitutes a major share of current assets in almost all the mills under study. Kandagiri has major investment (62.33 per cent) in inventory of all the mills taken together. Amarjothi, Kallam and Gem mills have invested more than 50 per cent of current assets investment in inventory.

Receivables constitute a second major item of investment in current assets in Suryalata. Next to it ranks Suryaamba and Gem. Pasari has the high C.V value of 0.44 indicates that variations in the level of investment. Cash balances have claimed comparatively proportion of current assets. Percentage of cash can be noticed maximum on the average in Pasari (20.79) and minimum in the Suryalata (0.95)

Next to inventory and trade receivables short term loans and advances constitute a major item in the list of current assets of sample mills except in Kallam mill. The mean values of this ration shows that Kallam had invested heavily in 'short term loans and advances' and next to it Aditya mill invested in short term loans and advances with high variation as compared to all other spinning mills under study.

10. Structure of gross working capital

The size of investment in current assets occupy a major part of investment. This can be further enlightened by making a in depth study by computing the ratio of current assets to total assets, current assets to fixed assets and so on.

10.1. Ration of current assets to total assets.

This ratio shows the proportion of current assets in the total assets. The greater the liquidity and the lower the risk of technical insolvency, at the same time low profitability. On contrast, the lower the percentage of current assets to sales, the greater the profitability on investments in current assets.

The values of mean (X), coefficient of variation of ratios concerning the size of gross working capital. The average values indicates that the size of investment in current assets 32.38. on an average all the sample spinning mills have invested less than 5. Per cent of total assets in the form of current assets. During the study period, the size of investment is more in Amarjothi (43.57) and Surya Vanshi (40.36) respectively on an average. The size of investment is less compared to total average (32.83) in Pasari (17.19), Aditya (28.25), Kallam (30.76) and Kandagiri (30.77) respectively on an average.

The ratio of current assets to total assets varied widely within the individual firms, Aditya 8.40 per cent to 48.48 per cent, Kallam 24.31 per cent to 40.07 per cent, Suryaamba 29.43 per cent to 44.70 per cent, Suryalata 29.09 percent to 38.39 percent, Suryavanshi 32.83 percent to 39.95 percent, Amarjothi 36.16 percent to 55.10 percent, Gem 10.24 percent to 67.37 percent, Kandagiri 20.31 percent to 38.52 percent, Sambandam 21.88 percent to 42.71 percent, Pasari 0.18 percent to 58.39 percent. The values of co-efficient of variation ranging between 0.10 to 1.44 for current to total assets ratio in the sample mills. The above values reveal that Suryalata has less variation in the ratio implying consistency throughout the study period, where as Pasari recorded a high variation of 1.44 indicates that fluctuations in currents assets to total assets ratio.

10.2. Ratio of current assets in terms of number of days of sales

The average value for the ratio of current assets in terms of number of days of sales averaged to 183.82 in the select spinning mills. The higher mean value of sample mills is due to the low utilization of current assets by Pasari whose average stood at 580.55, almost eight times more than Adiya. Aditya has a low mean value of 70.94 indicates that a better utilization of current assets compared to the remaining sample mills. The other mills of Suryaamba (76.90) and Suryalata (84.69) almost are on the same verge. Gem (224.68) and Amarjothi (203.61) also have not been able to exercise better control over current assets. The values of co-efficient of variation fluctuates between 0.14 to 1.98 in sample mills. Though the variation seems to be more in the Pasari due to high C.V value of 1.98. whereas the Kallam is having C.V of 0.14. it implying consistency and more effective utilization of current assets.

11. Utilisation of gross working capital

After determining the size of investment in gross working capital it is essential to know how far the current assets are being used efficiently. This can be clearly found by studying the behavior of turnover of current assets over a period of time. The utilization of current assets can be determined by working out the ratio of current assets turnover. The ratio indicated that the number of times are average current assets are encircling during the year. An increase in the ratio is an indication of improvement in the utilization of current assets and vice versa. But a very high ration may be indication of insufficient investment in current assets for a given volume of business. The average turnover is 5.26. Pasari spinning mill has a high mean value of 22.51 which may be due to insufficient investment in current assets. Though the mean value of Amarjothi (1.93) and Kallam (2.06) appears to be low, implies that low utilization of current assets and low operating cycle.

When the turnover of current assets is compared over a period of time for individual mills. It may be observed that the utilization of current assets has shown an improvement in the majority of the sample mills. It varies from 2.21 to 5.87 for Aditya, 1.69 to 2.59 for Kallam, 3.51 to 5.95 for Suryaamba, 3.40 to 5.42 for Suryalata, 2.40 to 5.20 for Suryavanshi, 1.12 to 2.65 for Amarjothi, 0.61 to 4.21 for Gem, 1.68 to 3.64 for Kandagiri, 1.45 to 3.43 for Sambandam, 0.13 to 72.00 for

Pasari. Thus the variation in gross working capita turnover is the highest for Pasari mill in Comparison with other sample mills.

A very high amount of variation is observed in Pasari mill with the C.V value of 1.41, where as the Suryalatha having low C.V value of 0.14 implying more consistency management of gross working capital.

12. Conclusion

Current assets should be properly planned, directed, individually and collectively and are to be kept under continuous scrutiny. For this purpose, the various practices,

adopted by the select mills are obtained from the sample units. top level executives known by different names in different mills shoulder the responsibility of managing working capital. They are adopting percentage of current assets to fixed capital, percentage of production and operating cycle approach to determine the levels of working capital. They are allocating it to its various segments by preparing budgets and basing on production estimate and they control investment in working capital by preparing periodical production/sales budget report and budgetary control. They reviewing working capital quarterly and monthly and one unit responded that it is reviewing working capital position almost daily.

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