

FINANCING OF WORKING CAPITAL IN SELECT CEMENT

COMPANIES OF ANDHRA PRADESH

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ABSTRACT

The primary aim of working capital management of any business firm is to maintain a balance between two contradictory factors i.e. liquidity and profitability. It depends upon the financing of working capital of the firm. A business firm can explore various sources of financing to meet its investment in current assets. Generally the long term sources of finance provide support for a relatively small proportion of current assets requirements. On the other hand, short-term sources provide for a major portion of investment in current assets. Depending upon the extent of the use of long term and short term sources to finance its current assets, a firm is said to be following conservative or aggressive or matching approach. This paper makes an attempt to analyze the pattern of financing the current assets in select cement companies and also examine the over or under-utilization of bank finance for working capital requirements when compared to the norms of Tandon Committee. The analysis of financing of current assets revealed the heavy dependence of the select units on short term borrowings, account payables and other current liabilities. Long term sources have minor share in this regard. It is further found that excesses borrowings were noticed in all units except DCL as per first method and in all units as per second method in some years during the study period.

KEYWORDS: Bank Finance, Liquidity, Long Term Sources, Net Working Capital, Profitability

INTRODUCTION

The primary aim of working capital management of any business firm is to maintain a balance between two contradictory factors i.e. liquidity and profitability. It depends upon the financing of working capital of the firm. A business firm can explore various sources of financing to meet its investment in current assets. Generally the long term sources of finance, like, equity share capital, preference share capital, long-term debts, etc., provide support for a relatively small proportion of current assets requirements; such finance is known by the name of 'net working capital' or 'working capital margin' or 'working capital gap'. On the other hand, short-term sources, such as bank credit, public deposits, commercial papers and spontaneous sources like, trade credit, accrued expenses and deferred income provide for a major portion of investment in current assets.

Depending upon the extent of the use of long term and short term sources to finance its current assets, a firm is said to be following conservative or aggressive or matching approach. If the dependence on long term sources is high, the firm is said to be following conservative approach. On the other hand, if the dependence on the short term sources is high, the firm is said to be following aggressive approach. Both these policies are not good from the point of view of efficient management of working capital because the conservative approach gives importance to only liquidity at the cost of

profitability, while the aggressive approach gives importance to profitability at the cost of liquidity. Therefore, a firm is supposed to follow a trade off or matching approach which gives equal weightage to both liquidity and profitability. A trade off approach suggests that the portion of permanent working capital should be financed by the long term sources and the temporary working capital from short term sources. However, it is very difficult for external analysts to categorize permanent and seasonal working capital in any firm.

This section makes an attempt to analyze the pattern of financing the current assets in select cement companies and also examine the over or under-utilization of bank finance for working capital requirements when compared to the norms of Tandon Committee.

REVIEW OF LITERATURE

A brief review of the different researches in the field is attempted in the following paragraphs.

Sherin: in her article on “Liquidity v/s profitability - Striking the right balance” writes about the implications of liquidity and profitability in a pharmaceutical company. A firm is required to maintain a balance between liquidity and profitability while conducting its day to day operations. Investments in current assets are inevitable to ensure delivery of goods or services to the ultimate customers. A proper management of the same could result in the desired impact on either profitability or liquidity.

Elijelly: in the study on “Liquidity – profitability tradeoff: An empirical investigation in an emerging market” empirically examined the relation between profitability and liquidity, as measured by current ratio and cash gap (cash conversion cycle) on a sample of joint stock companies in Saudi Arabia. The study found significant negative relation between the firm’s profitability and its liquidity level, as measured by current ratio.”

Nandi Chandra Kartik: in his paper on “Trends in Liquidity Management and Their Impact on Profitability: A Case Study” makes an attempt to assess the trends in liquidity management and their impact on profitability. An attempt has been made to establish the linear relationship between liquidity and profitability with the help of a multiple regression model. On the basis of overall analysis, it is therefore important to state that the selected company always tries to maintain adequate amount of net working capital in relation to current liabilities so as to keep a good amount of liquidity throughout the study period.

Brahma: conducted a study to examine and evaluate the importance of liquidity management on profitability as a factor accountable for poor financial performance in the private sector steel Industry in India.

OBJECTIVES OF THE STUDY

- To analyze the pattern of financing the current assets in select cement companies
- To examine the over or under-utilization of bank finance for working capital requirements when compared to the norms of Tandon Committee.

RESEARCH METHODOLOGY

Sample under Study

Samples of six cement companies of Andhra Pradesh have been purposefully selected for the study. They are:

- Anjani Portland Cements Ltd. (APCL)
- Bheema Cements Ltd. (BCL)
- Deccan Cements Ltd. (DCL)
- NCL Industries Ltd. (NCL)
- Panyam Cements and Mineral Industries Ltd. (PCMIL)
- Sagar Cements Ltd. (SCL)

Scope of the Study

The present study is restricted to the above mentioned six select cement companies of Andhra Pradesh.

Period of the Study

The study was performed on data of 10 years from 2003-04 to 2012-13.

Data Collection

To achieve the aforesaid objectives data is gathered from secondary sources like annual reports of select cement companies, journals, related other research papers, websites etc.

Tools of Analysis

To analyze the data, percentages and norms of Tandon Committee are used for the present study.

LIMITATIONS OF THE STUDY

- The study covers the period from 2003-04 to 2012-13. The changes that took place before and after this period were not taken into consideration,
- The data are secondary in nature and any bias in them is reflected in the analysis and the conclusion of the study.

DATA ANALYSIS

- **Analysis of the Pattern of Financing the Current Assets in Select Cement Companies**

The financing pattern of current assets in select cement companies has been presented in the table 1. This table reveals that the proportion of long term sources has fluctuated between -130.26 per cent and 60.37 per cent during the study period in the industry and on an average, it was 4.92 per cent. It can be said that the long term sources has contributed a minor share on an average in the industry. In select units also, this source has been showing a fluctuating trend. Individually, the average proportion of this source was 37.25 per cent in APCL, 46.96 per cent in BCL, 40.89 per cent in DCL, 9.62 per cent in NCL, -124.87 per cent in PCMIL and 19.69 per cent in SCL during the study period. However, it was a major source in APCL, BCL and DCL and a minor source in NCL and SCL. But, PCMIL could not use this source in financing its current assets in half of the years of study period and that too, the proportion of this source was negative in this unit.

Table 1: Financing Pattern of Current Assets in Select Cement Companies

Particulars	(In percentage)											C.V.
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	×	
APCL												
a) Long term sources	53.21	48.00	59.68	54.91	38.72	47.18	65.74	1.29	2.12	1.62	37.25	65.18
b) Short-term borrowings	23.43	25.96	19.95	16.55	20.53	8.82	6.88	40.66	33.20	39.59	23.56	46.78
c) Trade payables	18.70	20.77	16.00	13.26	16.43	21.02	25.79	10.93	16.40	14.90	17.42	23.37
d) Other Current Liabilities	4.66	5.19	4.01	3.33	4.11	0.15	0.24	45.14	44.09	43.48	15.44	122.56
e) Short-term provisions	0.00	0.07	0.36	11.94	20.22	22.83	1.34	1.97	4.19	0.41	6.33	131.71
BCL												
a) Long term sources	15.82	59.18	52.91	66.95	67.21	65.20	78.63	46.27	16.85	0.63	46.96	53.68
b) Short-term borrowings	42.36	20.41	23.57	7.56	6.98	19.74	5.43	22.32	49.37	41.46	23.92	62.35
c) Trade payables	33.83	16.30	18.84	10.11	7.22	6.06	6.25	24.95	17.20	32.95	17.37	57.04
d) Other Current Liabilities	8.00	4.11	4.68	9.79	4.76	3.64	3.23	6.46	16.58	24.95	8.62	77.04
e) Short-term provisions	0.00	0.00	0.00	5.60	13.83	5.36	6.47	0.00	0.00	0.00	3.13	141.26
DCL												
a) Long term sources	21.15	14.44	37.39	63.36	44.04	32.86	56.70	29.47	29.53	79.93	40.89	47.13
b) Short-term borrowings	34.40	36.92	26.07	4.86	5.10	19.53	7.02	16.37	21.06	6.26	17.76	64.28
c) Trade payables	27.51	29.53	20.84	4.65	4.49	5.86	16.65	11.54	15.57	6.38	14.30	62.05
d) Other Current Liabilities	6.86	7.39	5.21	5.63	9.45	8.79	6.48	34.10	22.81	3.34	11.01	83.84
e) Short-term provisions	10.09	11.71	10.49	21.49	36.92	32.97	13.16	8.52	11.02	4.09	16.05	64.45
NCL												
a) Long term sources	-11.81	-0.46	13.26	23.88	50.21	46.15	55.60	69.71	-53.06	-97.31	9.62	518.16
b) Short-term borrowings	52.45	44.29	37.10	30.00	10.64	9.49	17.67	13.74	46.50	53.11	31.50	52.69
c) Trade payables	41.97	35.42	29.68	24.01	5.15	10.67	14.82	1.81	18.54	28.62	21.07	59.29
d) Other Current Liabilities	10.49	8.84	7.41	6.00	21.24	20.00	7.69	9.98	74.39	112.03	27.81	122.69
e) Short-term provisions	6.91	11.91	12.55	16.11	12.75	13.69	4.22	4.76	13.64	3.54	10.01	44.01
PCMIL												
a) Long term sources	-119.66	-178.97	-948.20	-187.92	-40.45	68.52	64.36	64.09	27.15	2.44	-124.87	-232.13
b) Short-term borrowings	65.89	83.68	314.41	86.33	42.10	3.42	9.39	7.39	20.23	26.88	65.97	133.18
c) Trade payables	43.94	55.81	209.69	57.55	28.08	3.74	6.94	8.46	7.18	12.96	43.44	135.42
d) Other Current Liabilities	109.83	139.49	524.10	143.88	70.18	21.26	12.58	13.23	43.11	53.46	113.11	127.93
e) Short-term provisions	0.00	0.00	0.00	0.16	0.09	3.06	6.73	6.83	2.33	4.26	2.35	112.49
SCL												
a) Long term sources	29.29	33.64	3.38	6.52	19.35	54.39	41.20	43.20	-29.48	-4.61	19.69	123.93
b) Short-term borrowings	35.32	30.72	44.88	33.03	26.99	16.25	21.81	23.51	38.29	30.91	30.17	26.43
c) Trade payables	28.25	24.57	35.91	26.41	21.60	17.79	25.03	21.32	36.96	24.16	26.20	22.20
d) Other Current Liabilities	7.07	6.15	8.97	6.62	5.40	5.72	5.04	6.55	44.42	47.16	14.31	110.31
e) Short-term provisions	0.07	4.91	6.85	27.43	26.65	5.86	6.92	5.42	9.81	2.37	9.63	94.03
AVERAGE												
a) Long term sources	-2.00	-4.03	-130.26	4.62	29.85	52.38	60.37	42.34	-1.15	-2.88	4.92	1033.36
b) Short-term borrowings	42.31	40.33	77.66	29.72	18.72	12.88	11.37	20.67	34.78	33.04	32.15	57.10
c) Trade payables	32.37	30.40	55.16	22.67	13.83	10.86	15.91	13.17	18.64	20.00	23.30	53.99
d) Other Current Liabilities	24.49	28.53	92.40	29.61	19.19	9.93	5.88	19.24	40.90	47.40	31.72	74.17
e) Short-term provisions	2.85	4.77	5.04	13.79	18.41	13.96	6.47	4.58	6.83	2.45	7.92	65.52

Source: Annual Reports of Select Cement Companies.

A short term borrowing from banks was the major source in the industry. The proportion of this source has been showing a fluctuating trend during the study period and constituted on an average 32.15 per cent of the total current assets in the industry. In select units also, the proportion of short term borrowings has been showing a fluctuating trend during the study period. On an average, the proportion of this source was 23.56 per cent in APCL, 23.92 per cent in BCL, 17.76 per cent in DCL, 31.50 per cent in NCL, 65.97 per cent in PCMIL and 30.17 per cent in SCL during the study period. Individually also, it was a major source in NCL PCMIL and SCL.

The proportion of trade payables has been showing a fluctuating trend during the study period and constituted on an average 23.30 per cent of total current assets in the industry. In select units also, the proportion of trade payables has been showing a fluctuating trend during the study period. On an average, the proportion of trade payables was 17.42 per cent in APCL, 17.37 per cent in BCL, 14.30 per cent in DCL, 21.07 per cent in NCL, 43.44 per cent in PCMIL, and 26.20 per cent in SCL during the study period.

The major source of financing the current assets was the other current liabilities in the industry. The proportion of this source has been showing a fluctuating trend during the study period and constituted on an average 31.72 per cent, of total current assets in the industry. In select units also, the proportion of other current liabilities has been showing a

fluctuating trend during the study period. On an average, the proportion of other current liabilities was 15.44 per cent in APCL, 8.62 per cent in BCL, 11.01 per cent in DCL, 27.81 per cent in NCL, 113.11 per cent in PCMIL, and 14.31 per cent in SCL during the study period.

The short term provisions also contributed to the extent of 7.92 per cent in the industry, 6.33 per cent in APCL, 3.13 per cent in BCL, 16.05 per cent in DCL, 10.01 per cent in NCL, 2.35 per cent in PCMIL and 9.63 per cent in SCL on an average during the study period.

Thus, it can be concluded that the industry has been financing their major portion of current assets from other current liabilities, short term borrowings and trade payables. The portion of long term sources in this regard were very minor and therefore, said to be following aggressive approach. This implies that the industry has been giving much importance to the profitability at the cost of liquidity.

- **Analysis of the Over or Under-Utilization of Bank Finance for Working Capital Requirements When Compared to the Norms of Tandon Committee**

With regard to the utilization of bank credit, the borrowing of individual units has been compared with recommendations of the Tandon Committee, which has quantified the desirable level of net working capital and maximum permissible lending by commercial banks in meeting working capital needs. The committee, taking a pragmatic view of the situation, suggested three methods of determining the eligible bank finance in such a manner that each successive method would call for a larger proportion of involvement by companies of their long term funds in current assets and decrease in bank finance. Keeping in view the recommendations of the Tandon Committee to consider the existing status of bank borrowings in select units, the deviations of actual bank borrowings from maximum permissible limits under the first and second methods of financing have been presented in the tables 2 and 3.

Table 2: Maximum Limit under First Method and Actual Borrowings in Select Cement Companies

Year	Component	(Rs. In Crore)						
		APCL	BCL	DCL	NCL	PCMIL	SCL	Total
2004	Max.Limit	8.15	4.97	14.09	12.62	-11.08	13.98	42.73
	Actual borrowings	3.32	4.82	11.63	21.71	18.10	10.19	69.77
	Deviation	4.83	0.15	2.46	-9.10	-29.18	3.79	-27.05
2005	Max.Limit	7.48	9.01	11.42	14.16	-16.73	15.54	40.88
	Actual borrowings	3.50	3.08	10.94	19.08	19.58	9.89	66.07
	Deviation	3.98	5.93	0.48	-4.92	-36.31	5.65	-25.19
2006	Max.Limit	9.97	10.54	19.19	22.28	-38.27	8.56	32.27
	Actual borrowings	3.33	4.33	10.51	21.88	25.31	10.61	75.97
	Deviation	6.64	6.21	8.68	0.40	-63.58	-2.05	-43.70
2007	Max.Limit	15.93	15.98	38.71	34.39	-29.15	11.60	87.46
	Actual borrowings	4.92	2.16	3.68	25.53	33.03	12.52	82.24
	Deviation	11.01	13.82	35.03	8.86	-62.18	-1.32	5.22
2008	Max.Limit	18.40	21.28	38.11	64.85	1.00	21.29	164.93
	Actual borrowings	8.50	2.67	5.27	15.12	33.86	16.53	81.95
	Deviation	9.90	18.61	32.84	49.73	-32.86	4.76	82.98
2009	Max.Limit	17.00	50.16	54.02	60.95	72.20	66.80	321.13
	Actual borrowings	3.57	15.54	26.85	13.86	4.58	20.49	84.89
	Deviation	13.43	34.62	27.17	47.09	67.62	46.31	236.24
2010	Max.Limit	31.21	42.59	48.89	78.17	82.19	64.59	347.64

Table 2: Contd.,

	Actual borrowings	3.94	3.67	7.18	25.14	13.95	29.81	83.69
	Deviation	27.27	38.92	41.71	53.03	68.24	34.78	263.95
2011	Max.Limit	28.21	43.14	47.24	107.59	78.44	86.56	391.18
	Actual borrowings	36.45	18.72	22.49	23.62	10.81	40.67	152.76
	Deviation	-8.24	24.42	24.75	83.97	67.63	45.89	238.42
2012	Max.Limit	29.35	46.10	60.26	-8.79	53.29	13.42	193.63
	Actual borrowings	36.78	45.83	33.44	83.03	30.34	77.71	307.13
	Deviation	-7.43	0.27	26.82	-91.82	22.95	-64.29	-113.50
2013	Max.Limit	39.68	34.40	314.57	-49.01	25.80	43.78	409.22
	Actual borrowings	50.82	45.18	30.46	78.51	31.54	68.59	305.10
	Deviation	-11.15	-10.78	284.11	-127.52	-5.74	-24.81	104.11

Source: Annual Reports of Select Cement Companies.

The table reveals that the industry has succeeded in controlling bank credit in six years during the study period as per first method. In select units, DCL has succeeded fully in controlling bank credit throughout the study period. BCL also, except in 2012-13, has succeeded in controlling bank credit. APCL, NCL, PCMIL and SCL have exceeded their borrowings in three years, four years, six years and four years respectively during the study period as per first method.

Table 3: Maximum Limit under Second Method and Actual Borrowings in Select Cement Companies

Year	Component	(Rs. In Crore)						
		APCL	BCL	DCL	NCL	PCMIL	SCL	Total
2004	Max.Limit	7.32	3.78	10.33	6.47	-21.64	11.43	17.69
	Actual borrowings	3.32	4.82	11.63	21.71	18.10	10.19	69.77
	Deviation	4.00	-1.05	-1.30	-15.24	-39.74	1.24	-52.09
2005	Max.Limit	6.60	8.24	7.81	8.11	-28.15	12.67	15.28
	Actual borrowings	3.50	3.08	10.94	19.08	19.58	9.89	66.07
	Deviation	3.10	5.16	-3.13	-10.97	-47.73	2.78	-50.79
2006	Max.Limit	9.12	9.46	15.50	14.96	-53.03	5.50	1.51
	Actual borrowings	3.33	4.33	10.51	21.88	25.31	10.61	75.97
	Deviation	5.79	5.13	4.99	-6.92	-78.34	-5.11	-74.46
2007	Max.Limit	13.81	14.15	32.70	24.58	-48.44	5.69	42.49
	Actual borrowings	4.92	2.16	3.68	25.53	33.03	12.52	82.24
	Deviation	8.89	11.99	29.02	-0.95	-81.47	-7.23	-39.75
2008	Max.Limit	14.18	18.81	24.96	50.94	-18.78	13.07	103.18
	Actual borrowings	8.50	2.67	5.27	15.12	33.86	16.53	81.95
	Deviation	5.68	16.14	19.69	35.82	-52.64	-3.46	21.23
2009	Max.Limit	12.55	47.20	37.65	44.75	62.81	57.55	262.51
	Actual borrowings	3.57	15.54	26.85	13.86	4.58	20.49	84.89
	Deviation	8.98	31.66	10.80	30.89	58.23	37.06	177.62
2010	Max.Limit	27.29	39.90	39.61	68.67	72.44	51.95	299.86
	Actual borrowings	3.94	3.67	7.18	25.14	13.95	29.81	83.69
	Deviation	23.35	36.23	32.43	43.53	58.49	22.14	216.17
2011	Max.Limit	15.20	36.56	28.63	100.48	68.00	72.16	321.03
	Actual borrowings	36.45	18.72	22.49	23.62	10.81	40.67	152.76
	Deviation	-21.25	17.84	6.14	76.86	57.19	31.49	168.27
2012	Max.Limit	11.43	38.26	40.64	-56.36	33.56	-32.84	34.69
	Actual borrowings	36.78	45.83	33.44	83.03	30.34	77.71	307.13
	Deviation	-25.35	-7.57	7.20	-139.39	3.22	-110.55	-272.44
2013	Max.Limit	20.81	18.63	297.78	-102.30	5.07	2.90	242.89
	Actual borrowings	50.82	45.18	30.46	78.51	31.54	68.59	305.10
	Deviation	-30.01	-26.55	267.32	-180.81	-26.47	-65.70	-62.22

Source: Annual Reports of Select Cement Companies.

The table 3 shows the deviations of actual borrowings from permissible bank borrowings as per second method.

As per this method the industry has exceeded its limit in six years during the study period. In select units, excesses borrowings were noticed in all units during the study period. APCL and BCL in three years each, DCL in two years, NCL and PCMIL in six years each and SCL in five years have exceeded their borrowings.

From this analysis, it can be concluded that majority of the units under the study are required to reduce the proportion of bank borrowings as a source of working capital even to satisfy the second alternative as suggested by the Tandon Committee.

CONCLUSIONS

The analysis of financing of current assets revealed the heavy dependence of the select units on short term borrowings, account payables and other current liabilities. Long term sources have minor share in this regard. This indicates the aggressive attitude of the management of the select units in financing the working capital. It is further found that excesses borrowings were noticed in all units except DCL as per first method and in all units as per second method in some years during the study period.

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