Chapter 1

Working Capital Management in Select Indian Pharmaceutical Companies: A Cross-Sectional Analysis

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ABSTRACT

The Indian pharmaceutical industry is the fifth largest pharmaceutical industry in the world in terms of volume and the fourteenth largest in value terms. There have been several notable changes in the scenario of Indian pharmaceutical industry after the signing of GATT (now WTO). The mergers, acquisitions, and takeovers at both national and international levels have become a common phenomenon in this industry. In today’s challenging and competitive environment, efficient management of working capital is an integral component of the overall strategy to create shareholders’ wealth. So, the task of designing appropriate strategies for managing working capital in accomplishing the objective of maximizing shareholders’ wealth of companies in the Indian pharmaceutical industry is of prime importance. In this backdrop, the chapter seeks to analyze the working capital management of ten selected companies in the Indian pharmaceutical industry during the period 1996-97 to 2010-11. While satisfying the objective of the study, relevant statistical tools and techniques have been applied at appropriate places.

DOI: 10.4018/978-1-4666-5154-8.ch001
1. INTRODUCTION

The arena of financial management is purely concerned with the procurement of fund and its effective utilization to achieve the fundamental objective of wealth maximization. Working capital is considered as the life blood of an organization. Effective management of short term assets and liabilities have direct impact on the earning capability of the firm. Thus the finance managers in the corporate world make relentless effort to ensure efficiency in working capital management so as to amplify the profitability with adequate liquidity. The history of finance shows several incidences where firms became bankrupt due to mismanagement of working capital. Recently a lot of changes have been taken place in the working capital management (WCM)practices in the corporate sector across the globe. Due to the abundant supply of short term credit facilities from banks and other financial institutions, a good number of well known business houses are maintaining zero working capital and moving towards JIT purchase approach which has a considerable positive impact on the profitability of the firm. There has been a sharp decline in the strength of Indian currency as compared to other important currencies of the globe. It has a significant impact on the receivables and payables of the companies having overseas operation such as IT companies, pharmaceutical companies etc. Hence the finance managers in the corporate sector have been facing a real challenge at the time of managing the components of working capital prudently. In this backdrop, a modest effort has been made to carry out a comprehensive empirical assessment of WCM of the ten selected companies in Indian Pharmaceutical industry during the period 1996-97 to 2010-11.

2. REVIEW OF EXISTING LITERATURE

Over a long period of time many research scholars have made significant contribution in the literature of finance by conducting unique and fruitful empirical research studies on WCM at both national and international levels. Some notable studies were reviewed in the following paragraphs for the purpose of identifying the research gap.

The findings of the empirical investigation conducted by Carpenter and Johnson (1983) showed that no linear relationship between the revenue systematic risk of US firms and level of current assets was present; rather they found non-linear relationship which was not observed to be statistically significant.

Lyroudi and Lazaridis, (2000) carried out an analysis of the Greek Food Industry to establish the relationship between the Cash Conversion Cycle and the traditional liquidity indicators. The results revealed a significant and positive linkage between the modern and traditional liquidity indicators. The Cash Conversion Cycle was also seen to be positively related with the Return on Assets.

The study undertaken by Eljelly (2004) on a sample of 929 joint stock companies in Saudi Arabia also showed that there was a significant negative relationship between the firm’s profitability and its liquidity.

The study conducted by Ghosh and Maji (2004) for analyzing the relationship between working capital management and profitability of the Indian cement industry observed significant association between the earning capacity and outstanding use of current assets. Mohamad and Saad (2010) got similar inputs from their study of working capital management and market valuation of 172 Malaysian firms for the period 2003 to 2007.

Mallik et al. (2005) conducted their study on working capital management of Indian pharmaceutical industry and found no significant relationship between working capital and profitability.