Chapter 12

Working Capital Management: A Study Based on Cipla Ltd.

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ABSTRACT

It is expected that proper management of working capital contributes positively to the value of the firm, and liquidity of the firm negatively affects the profitability of the company. The purpose of the chapter is to analyze the composition and changes of the working capital and to find the impact of liquidity and efficiency of working capital management on profitability. For this purpose, this study is conducted on Cipla Ltd. for the period 2001-2009. From the study, it is found that there is a significant negative relationship between liquidity and profitability. It also reveals that managers can create value for the firm by reducing the holding period in inventories and receivable.

INTRODUCTION

Working capital is the part of the capital which is required for day to day operation of the business. So it is considered as lifeblood for any business. Working capital management is an important area of financial management. Management of working capital means management of various components of working capital in such a way that an adequate amount of working capital is maintained for smooth running of the firm. A firm is required to maintain a balance between liquidity and profitability while conducting its day to day operations. Liquidity means that sufficient cash is available to make the payment of the liabilities when they become due. On the other hand profitability means profit earning capacity of the firm. If the firm utilizes the funds properly, the profitability of the business firm increases. There is an inverse relationship between liquidity and profitability. If too much emphasis is laid on liquidity, cash will not be invested in profitable channels and profitability of the firm will suffer. On the other hand if a major portion of the funds available is invested in profitable activities to increase the profitability of the business firm then liquidity will be hampered. For this reason the determination of optimum working capital
is very difficult. The amount of working capital depends on nature of business, scale of operation, production cycle, credit policy availability of raw materials etc.

Efficient management of working capital is an important indicator of sound health of an organization. Therefore, the working capital management needs attention of all financial managers. In this paper an attempt has been made to analyze the working capital management of Cipla Ltd during the period 2000-01 to 2008-09.

**Objectives of the Study**

1. To study the different composition of working capital and changes in working capital position of Cipla Ltd. during the study period.
2. To study the liquidity position of Cipla Ltd. by taking different components of working capital.
3. To analysis the selected ratios of working capital management.
4. To study the relationship between liquidity and profitability.
5. To study the impact of liquidity and length of cash conversion cycle (CCC) on profitability.

**Review of Literature**

Sur (2001) studied the association between liquidity and profitability of Indian private sector enterprises as a case study of aluminum producing industry. He concluded that liquidity variables jointly influenced profitability of the selected companies.

Ghosh and Maji (2003) examined the efficiency of working capital management of Indian cement companies during 1992-93 to 2001-02. They used performance, utilization and overall efficiency indices for measuring efficiency of working capital management. They concluded that Indian cement Industry as a whole did not perform remarkably during this period.

Kesseven (2006) investigated the trend in working capital and its impact on firm’s performances on 58 small manufacturing firms, using panel data analysis for the period 1998-2003. He concluded that there is inverse relationship between investment in inventories and profitability. He found that best practices in the paper industry contributed to the performance.

Abdul and Nasr(2007) studied the impact of liquidity on profitability. They conducted the study on selected 94 Pakistani firms listed on Karachi Stock Exchange and found a significant negative relationship between net operating profitability and average collection period, inventory turnover in days, average payment period and cash conversion cycle.

Kannadhasan (2007) examined the working capital management of Titan Industries for the period from 1998-99 to 2004-45. From the study it revealed that the liquidity position of the Titan industries is good and it remained above the standard norms throughout the period of study. He also concluded that the working capital management efficiency has been increasing every year during the study period.

**Database, Variables and Research Methodology**

The data of Cipla Ltd have been collected from the annual reports of the company. The present study covers a period of nine years from 2000-01 to 2008-09. The data collected from this source have been collected and complied with due care as per requirement of the study. The following variables used in the study:

1. **Current Ratio (CR):** It is the Ratio of current asset and Current liabilities. Current Ratio measures the ability of the firm to meet its current liabilities. This ratio is an indicator of short term liquidity position of the firm.

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