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An impact of negative working capital on profitability – A case study of selected cement companies in India

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Abstract
Working capital management is a concept that is gaining serious attention all over the world because of the current financial crisis and economic problems. Traditional financial analysts would consider liquidity management of companies playing a vital role to increase profitability and shareholders wealth, and also it shows the ability of a company to meet the short term obligations hence; it is significant to maintain liquidity position of the company as without it the company cannot survive. But in present business scenario many industries are using negative working capital and getting a good amount of profits and good return on capital also. The negative working capital indicates; lower cost of capital, but at the same time, it indicates poor liquidity position & high risk which is not good for any situation. This paper mainly focused on impact of negative working capital on profitability or not. The study covers a period of ten years from 2005 to 2014. The study was concluded as a positive relationship between the negative working capital and profitability and it leads to positive growth in earning per share & Equity dividend rate.

Keywords: Negative working capital, efficiency, profitability, liquidity

Introduction

Working capital is playing a major role in short term corporate finance, it is vital to enterprise survival & development and also play an main role in maximizing the shareholders wealth, But present scenario give more importance for minimizing the operating cost and maximize earning for the shareholders, which is the ultimate goal of the financial management. It can be achieved through negative working capital. It indicates quick realization of cash of the customers or cash conversion cycle is shorter. At the same time, longer payable policy regarding suppliers, a study of negative working capital and it impact on liquidity, profit earning capacity and overall impact on shareholders wealth creation is play important role in the current scenario.

Indian cement industry plays a significant role in the country‘s economic growth. the major contribution of cement industry such as housing, infrastructure and construction, real estate etc. India is the second largest producer of cement in the world. The production of cement in India has increased at compound annual rate (CAGR) of 9.7 % to reach 272 million tonnes (MT) in the period 2006 to 2013.it is expected to touch 407 MT by 2020 India‘s potential in infrastructure is vast. it has the capacity to becomes the world’s third largest construction market by 2025 adding 11.5 million homes a year to become a US $ 1 trillion a year market according to a study by global construction prospective and oxford economies. This open up a tremendous window of opportunity for the country‘s cement industry.

Maintaining negative working capital is really affects profitability of the firms, the study has been done on the basics of published Annual report of selected Indian cement company for a period of 10 years starting from 2005 to 2014.the present work aims to examine Negative working capital and its affect on profitability of Selected Indian cement company.

Concept of Negative Working Capital

Negative working capital (NWC) is defined as the excess of current liabilities over current assets. While calculating the net working capital, if the figure is found negative, it is called negative working capital. This situation indicates that current liabilities have financed100%of current assets and a portion of fixed assets also (by the amount it is negative).

Advantages of NWC
- Cost of working capital is lower; hence it leads to higher profitability
- It is good indicator of operational efficiency as inventories & account receivable are low
- It indicates that most of the daily activities are funded by customer
- The payment to the suppliers is to be made on a later dates, it indicates operational efficiency of trade credit

Disadvantages of NWC
- The high risk of bankruptcy & lower creditability in banks,
- Potential risk of winding up application by creditors,
- Lost trade discounts & bad supplier relationships etc.

Profile of the Sample Companies

Acc cements

Acc cement is engaged in the manufacturing of cement. It was established in the year 1936.The company having their corporate office in Mumbai, it is the one of the top cement company in India and also a leading player in ready mix concrete. It is part of world's leader Holcim group. The company have total assets Rs.8235.61 crore as on 31st December 2014.

Ultra Tech cement

Ultra Tech cement is engaged in the manufacturing cement & ready mix concrete. It was established in the year 1987. The company having their corporate office in Mumbai, it is largest clinker producer and exporter which have an annual capacity of more than 50 million tonnes. It is a flagship company of Aditya Birla group and leading cement company which acquired all ISO and OHSAS certifications. The company have total assets Rs. 21970.29 crore as on 31st march 2014

Madras cement

Madras cement, a flagship company of the Ramco Group, is a major player in the blended cement category in south India. The company was incorporated in the year 1957. Madras cement is the sixth largest cement producer in the country and the second largest in South India. The company having the corporate office in Chennai, it has an annual capacity to manufacture more than 13 million tonnes. The company have total assets Rs. 4908.82 crore as on 31st march 2015.

Objectives of the Study
- To study the structure of working capital of selected Indian cements company.
- To study the impact of negative working capital on profitability.
- To know the impact of negative working capital on wealth of shareholders.

Methodology of the Study

The present study has drawn a sample Size of three large companies listed in Indian stock exchange, namely ACC limited, Ultra Tech cement, Madras cement on the basis of total assets and whose financial information is available for the entire study period so as to meet our requirement. The data for the study period 2005 to 2014 have been collected from secondary data i.e. Annual reports of the companies and money control.com. Editing, classification and tabulation of the financial data collected from the above mentioned sources have been done as per the requirement of the study.

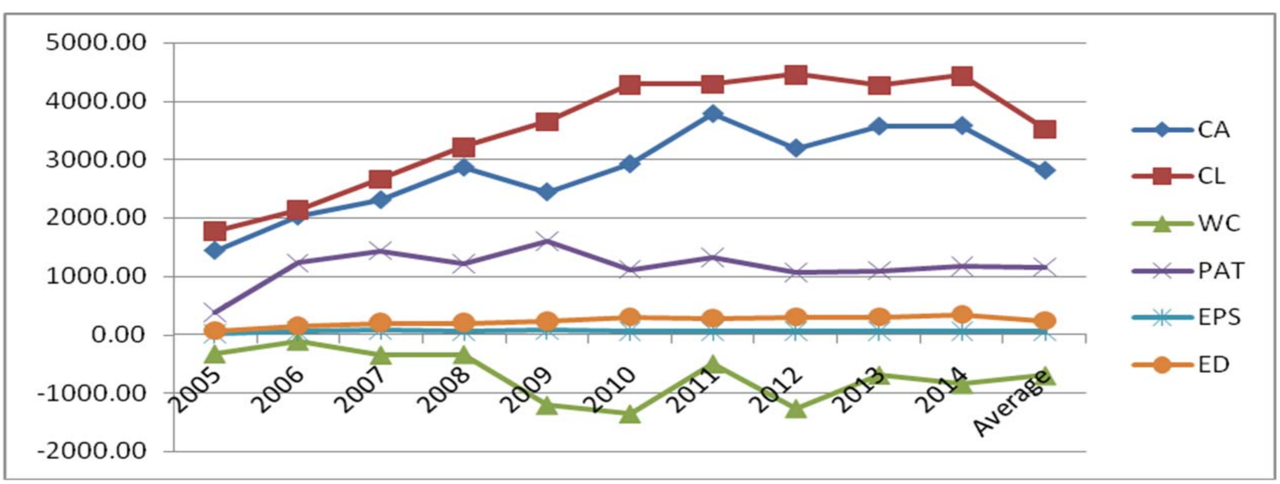
Limitation of the study
- The study is confined to ten years data only i.e. From 2005 to 2014, therefore a detailed analysis may be restricted.
- The study is based on the secondary data; therefore the quality of the study depends purely upon accuracy & quality of the data.
- The study is restricted to three sampled cement companies only.

Data analysis and discussions

Table 1: ACC Cement (Rs. In Crores)

Year	CA	CL	WC	PAT	EPS	ED
2005	1436.45	1765.79	-329.34	378.39	21.19	70.00
2006	2027.47	2138.33	-110.86	1231.84	65.78	150.00
2007	2307.94	2657.54	-349.60	1438.59	76.67	200.00
2008	2867.44	3209.32	-341.88	1212.79	64.62	200.00
2009	2443.61	3650.61	-1207.00	1606.73	85.58	230.00
2010	2925.70	4280.30	-1354.60	1120.01	59.66	305.00
2011	3791.18	4290.94	-499.76	1325.26	70.59	280.00
2012	3197.51	4458.40	-1260.89	1061.19	56.52	300.00
2013	3576.00	4268.75	-692.75	1095.76	58.36	300.00
2014	3585.33	4435.72	-850.39	1168.29	62.23	340.00
Average	2815.86	3515.57	-699.71	1163.89	62.12	237.50

Source: Annual reports of company

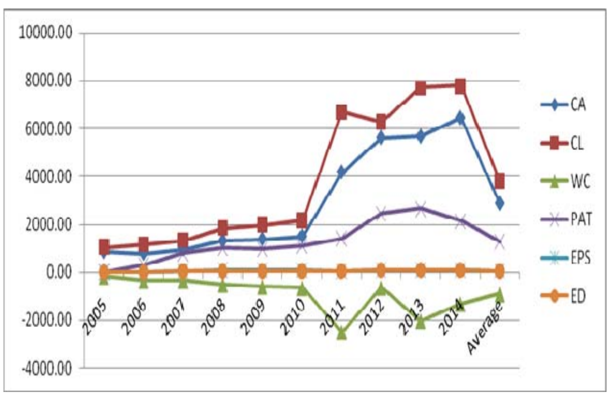


In case of ACC Cement, it is found that, Current assets & Current Liabilities have been quoted increasing trend during the year 2005 to 2014. Negative working capital has arisen all the years of study period & the average working capital for the whole ten years is negative i.e. Rs.(699.71) crore. It shows that company has managed to run the business without any working capital for the entire period of study. But it is surprised to see that impact of negative working capital on profitability is very much positive. PAT is quoted highest i.e. Rs.1606.73 Crores during the year 2010, but at the same year negative working capital quoted more than the average i.e. Rs. (1207) Crores. Earnings per share quoted highest i.e. Rs.85.58 during the year 2010 & equity dividend also shows increasing trend during the period of negative working capital.

Table 2: Ultra Tech Cement (Rs. In Crores)

Year	CA	CL	WC	PAT	EPS (Rs)	ED (%)
2005	850.78	1034.14	-183.36	2.85	0.23	7.50
2006	781.95	1142.44	-360.49	299.76	18.47	17.50
2007	972.13	1327.40	-355.27	782.28	62.84	40.00
2008	1317.49	1834.51	-517.02	1007.61	80.94	50.00
2009	1378.35	1982.39	-604.04	977.02	78.48	50.00
2010	1496.18	2153.61	-657.43	1093.24	87.82	60.00
2011	4182.13	6693.43	-2511.30	1404.23	51.24	60.00
2012	5623.62	6275.25	-651.63	2446.19	89.26	80.00
2013	5672.42	7711.37	-2038.95	2655.43	96.85	90.00
2014	6448.87	7783.72	-1334.85	2144.47	78.20	90.00
Average	2872.39	3793.83	-921.43	1281.31	64.43	54.50

Source: Annual reports of company

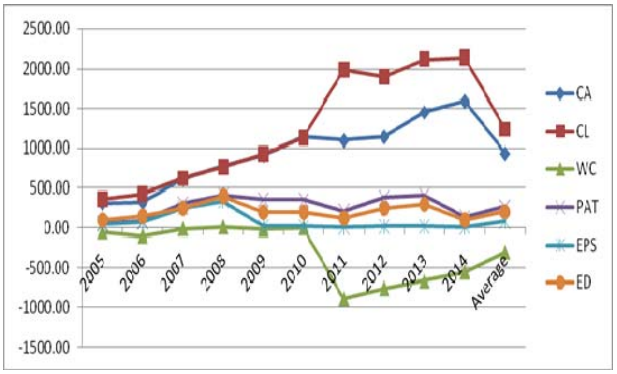


In case of Ultra Tech Cement, it is found that current assets and current liabilities have been quoted increasing trend during the study period. Negative working capital has been arisen all ten year of study period from 2005 to 2014. Negative working capital quoted highest i.e. Rs. (2511.30) crore during the year 2011 & also surprisingly quoted the profit after tax was Rs.1404.23 crore. The average working capital quoted negative all the ten years i.e. Rs. (921.43) crore. But impact of negative working capital on profit after tax is showing positive increasing trend during the whole study period. The negative working capital affect positively in the growth of earning per share and also in the payment of equity dividend.

Table3: Madras Cement (Rs. in Crores)

Year	CA	CL	WC	PAT	EPS (Rs)	ED (%)
2005	314.97	357.93	-42.96	55.92	46.30	100.00
2006	327.08	424.50	-97.42	79.02	65.43	150.00
2007	614.75	620.31	-5.56	308.02	255.03	250.00
2008	779.23	764.11	15.12	408.29	343.02	400.00
2009	913.80	930.27	-16.47	363.52	15.28	200.00
2010	1135.66	1131.34	4.32	353.68	14.86	200.00
2011	1098.76	1988.99	-890.23	210.98	8.87	125.00
2012	1144.54	1901.34	-756.80	385.11	16.18	250.00
2013	1455.06	2119.48	-664.42	403.65	16.96	300.00
2014	1589.84	2142.51	-552.67	137.70	5.79	100.00
Average	937.37	1238.08	-300.71	270.59	78.77	207.50

Source: Annual reports of company



In case of Madras Cement, it is found that the current assets and current liabilities are increasing trend during whole study period & out of ten years the company has seen the negative working capital in eight years. In the year 2008 & 2010 the working capital positive, but the average working capital for the entire period is also negative which is Rs. (300.71) crores. The company having negative working capital in the most of the years, still the company is managed to generate profit and the profitability position is improving. The PAT, EPS and ED rate have shown increasing trend, except one or two year. It shows company is well performing even with the negative working capital.

Findings

The following are the same of the main finding observed from the study

- It is found that Current assets & current liabilities are in increasing trend during the study period.
- The companies are successfully managing their day to day activities without any working capital.
- The study found that there is a positive relationship between the profitability and negative working capital.
- The negative working capital will improves rate of equity dividend and also earning per share of shareholders.

Conclusion

After analysing the data of all the selected companies, we can conclude that companies can run their business without having sufficient working capital in the day to day activities. The traditional analysis given more importance for maintaining sufficient working capital for maximise company profit and shareholders wealth. But in the new business area the companies maintaining sufficient working capital, then also not possible to generate good profit, because of high cost of capital, the new way of reducing cost of capital and increasing operating efficiency of company is negative working capital. It involves more risk, but it is very essential to maximise profit and survive in the competitive world.

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Abbreviations

CA: Current Assets
CL: Current Liabilities
NWC: Negative working capital
PAT: Profit after tax
ED: Equity Dividend
EPS: Earning Per share