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WORKING CAPITAL MANAGEMENT AND ITS EFFECT IN RETAIL SECTOR IN INDIA

Dr. Suresh Chand Singhal*

ABSTRACT

Retail sector which is one of the fastest growing sectors in the Indian economy is an area of research interest. The study focuses on understanding how the WCM in retail firms contributes to the profitability. The gaps in the existing literature studies indicate the requirement of detailed study to explain the impact of WCM on the profitability measures of Retail companies. It is felt that there is a need to make a new attempt to diagnose the advantage and opportunities for longer-term WC improvement. Working capital is the reflections of various efforts done by companies include debt management, CCC, ACP, Inventory mgmt. and APP. The requirement of WC depends on the nature of industry, and amount of WC can even differ among same type of companies. This can be due to influence of various factors like policies of payment and collection, operation cycle of organization, efficiency in credit policy, raw material availability and nature of business etc. A well designed and implemented WCM is expected to contribute positively to add value to the firm. The above research is undertaken with the object of study the different factors affecting the working capital of Indian retail sector firms and to examine the impact of different measures of working capital management (i.e. Average Collection Period, Inventory collection period, Cash Conversion Cycle, Average Payment Period) on the Profitability of the organised retail sector firms in India.

Keywords: *Profitability, Working Capital, Organization, Opportunities, Management, Efficiency.*

Introduction

Every business requires the amount for two basic needs i.e. for business establishment and its day to day operations. Businesses have need of long term assets like Land, Plant & Machinery, Building etc. and current assets. Fixed assets can be classified as those amounts in investments which are blocked on permanent basis. On second hand; for the acquirement of current assets, working capital is required; this is the amount of firm‘s capital needed for regular requirement for the purchase of raw materials, wages, rent and other daily routine activities. In general practices, working capital is the amount exceeds of current assets over current liabilities. Therefore, the working capital management is concerned with the problem that occurs while managing the short term assets, short term liabilities and their interrelationship. The prior purpose of management of working capital is to manage company‘s short term assets and current liabilities in a way that a satisfaction level is maintained i.e. it is neither inadequate nor excessive. This study is about the analyses the effect of WC on profitability in organized retail sector in India. Basic aim of this review of literature is to describe WC concepts, to outline existing performance measurement of working capital management concepts. Some research has been done in the field of relatively as of relationship between the working capital and its influences on the profitability of

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* Associate Professor, Department of Accounts & Law, (Faculty of Commerce) K.R. (P.G.) College, Mathura, U.P., India.

the organized retail market in Indian industry. Gaps in the existing research show that there is a need to make a fresh attempt to diagnose the ‗quick wins‘and longer-term WC improvement opportunities. The need of WC changes due to several factors like differences in policies of collection and payment, firm‘s production policy, operating efficiency, credit policy, availability of raw materials, nature of business, etc. To add in firm‘s value; a well formatted working capital management is required.

Literature Review

Anupam Jain (2010) tried to find out the WC effect and profitability in Indian Oil Drilling and Exploration Industry. Study included the variables of current ratio and cash conversion cycle to find out the impact from 2005-2009. The statistical method includes descriptive statistics; Pearson correlation matrix, regression and Anova were used for the data analysis. Research result the negative relationship between CCC and profitability and also has a positive relationship between the CR and firm‘s profitability.

S. M. Amir Shah et al. (2005) conducted a study on impact of WC on the profitability during the period 2001-05.A sample of Oil and Gas Sector of Pakistan listed firms were taken for study. Ratio Analysis, Correlation and regression analysis were performed under the study for analysis. Study concluded the adequate change of profitability due to the working capital of the firms.

Kessevan Padachi (2006) tried an attempt to study trends in management of WC and its impact on Mauritian firm‘s profitability. Panel data were used for 58 manufacturing firms for a period of 1998-2003. Sales, gearing ratio, current ratio, working capital turnover ratio used as control variables while the efficiency ratio, cash conversion cycle, accounts receivables, inventory turnover, Pearson correlation analysis and regression analysis were done to get the analysis of data. In study 5 paper industry showed positive results and research revealed the rising trend of short term working capital‘s components.

Sushma Vishnani et al., (2007) tried to study the impact of policies of working capital on the profitability of Industry. Sample of Indian Consumer Electronics Industry taken as a sample during the period of 1994-2005. Correlation analysis, regression analysis and ratio analysis was used for the data analysis under study. Reduction of sales volume increases the working capital level leads to increase the profitability of the firms.

A study done by **Virendar C. Jain (2007)** to find out the impact of management of working capital on fertilizer industry of Gujarat. The study taken the help of raw material tendency, credit tendency, cash tendency, the supplier‘s tendency to check the working capital position under fertilizer industry. Analysis was done for the period 1996-97 to 2004-05. Results was concluded under study with the help of Chi-square test, one way analysis of variance test by Kruskal Wallis, Standard Deviation, Arithmetic Mean, Index Number and Ratio Analysis that the fertilizer industry as very important as agriculture sector contributes 24% of GDP of the nation.

Mathuva (2009) examined in the study the working capital components. A sample of 30 firms listed on the Nairobi Stock Exchange was taken during the period 1993 to 2008. The objective of the study was to evaluate the influence of WCM components on corporate profitability. Results concluded that there exists a highly negative significant relationship between the accounts collection period and profitability while on the other hand there exists a positive relationship between the inventory conversion period and average payment period and profitability of the firms. There exists a direct relation with the average payment period and inventory conversion period and an inverse relationship between the average collection period and profitability

The Conceptualization in Management of Working Capital

For regular business operations, a company has to take capital budgeting decisions. Capital budgeting decisions are decisions related to the acquisition of the fixed assets which for a long period of time, normally exceeding one year. The decisions related to current assets which include a period of one year or less than a year time, is known as WC's decision. WC refers to the part of that amount of capital which is available for the running expenses and regular business operations. For example, the capital required for the purchasing of raw materials, direct and indirect expenses payments, maintain production investment in stock, receivables and to be maintained in the form of cash is generally described as working capital. In short, it is that amount of capital through which a business runs. For long term success, short term survival is most and because of that to manage the working capital is an important and integral aspect of financial management. The mgmt. of current assets is totally linked with the management of working capital. For day to day business operations; working capital is being used. It reflects the short term solvency position of the company. The mgmt. of WC is very necessary for the smooth running of company. Without an adequate amount of working capital; no business can run successfully. For financial efficiency of the company; WC is the parameter that concerned with the management of the CA over CL, where short term assets includes inventories, debtors, cash etc. while short term liabilities includes creditors, tax provision, short term loans, bank overdraft etc. Maintaining adequate level of WC includes company to get efficiency in solvency of the firm, goodwill, easily loans, cash discounts, and regular supply of raw materials, consistently payment of wages, and other daily operations. In time of crisis, company get ability to face, regular return on investment, exploitation of favorable market conditions, high morale etc. Low level of working capital retained by firm‘s leads to unbalance the liquidity level and high level of working capital in firms will lead to the profit‘s reduction. Because of this, an optimum level of WC is required, as the amount of working capital varies because of WC‘s nature like nature of the business, operational cycle, creditor‘s payment terms, scale of production, sales growth, availability of raw material etc., to achieve optimum WC level is a challenging task of the company.

Role of Working Capital in Retail Sector

The level of requirement of working capital is varying depending on industry to industry. Each industry requires working capital and it totally refers to the working capital cycle. The working capital cycle refers to the inventory collection days into collection of cash sales. In retail sector, mostly retailers want to keep high amount of working capital as in retail inventory sale off on slow basis as they have to maintain inventory level. In retail, retailers require a low working capital because retail consumers deal on cash basis at that time they buy the product and retailers have to pay suppliers on delay basis or later. Rise of consumer demand is one of the strongest pillars behind the retail market‘s growth. To increased turnover and better margins, every retailer needs working capital for their business operations. Lengthy documentation, delay disbursements, high interest rates, verification by third party, collateral security are the some challenges faced by the retailers in India. Retailers has to maintain the liquidity & profitability balance to achieve effective level of WC because high investment amount in working capital leads to more liquidity with less profit as it show the inefficiency of working capital. Low investment in working capital leads to less liquid with more profitability combination leads to efficiency in working capital. Increased in working capital can lead retails to gain bargaining power, plan inventory more efficiently. While small retailers in India is more rely on cash transactions for paying rent, wages, salaries, electricity bills and for documentation. This impact the profitability as if they deposit in bank they can improve the creditworthiness of their business.

Findings & Suggestions

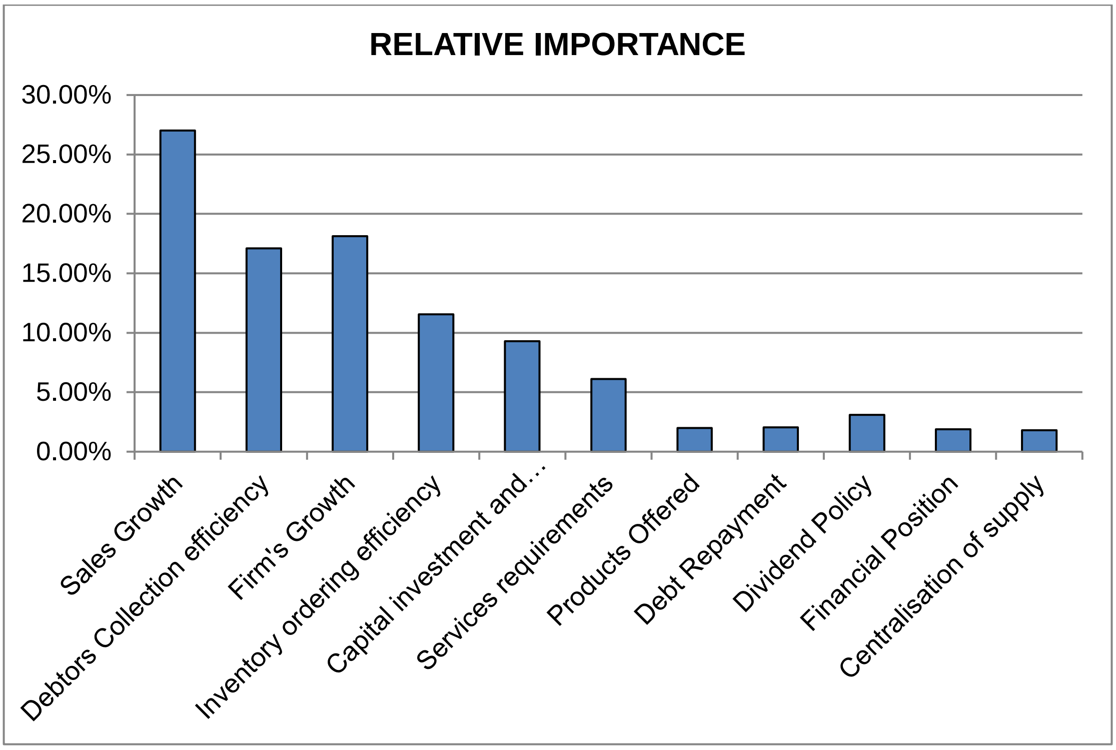
The below table shows the different factors which could influence the requirement of the working capital along with their relative importance. This will help to evaluate the impact of various factors on working capital.

Table: Relative and cumulative importance of different factors effecting working capital requirement

Different Factors Influencing the Requirement of WC of the Indian Retail Firms	Relative Importance	Cumulative Relative Importance
Sales Growth	27.01%	27.01%
Debtors Collection efficiency	17.09%	44.10%
Firm's Growth	18.13%	62.23%
Inventory ordering efficiency	11.55%	73.78%
Capital investment and Expenditure	9.28%	83.06%
Services requirements	6.12%	89.18%
Products Offered	1.98%	91.16%
Debt Repayment	2.04%	93.20%
Dividend Policy	3.10%	96.30%
Financial Position	1.89%	98.19%
Centralisation of supply	1.81%	100%

The above table indicates that sales growth (27.01 %) is the most influencing factor influencing the WC requirements of the firm. The firms with high sales growth need more inventories, more cash and other resources thereby need more working capital as per the expert‘s opinion. This is followed by the Debtors Collection efficiency (18.13%). The debtor‘s efficiency assures the firms about the speedy recovery of cash. Thus, efficiency in the collections from the debtors is found to second highest impact on the WC requirements of the companies. The third most important factors affecting the WC requirement includes company's growth (17.09%). Similar to the sales growth the growing firms plans to expand their capacity including both the FA as well as WC. The fourth important factors influence the working capital a requirement is found to be inventory ordering efficiency (11.55%). The efficiency of the inventory management within the company has a significant impact on the WC of the firm as per the expert response provided in the study. The other included factors are found to have less impact on working capital namely Capital investment and Expenditure (9.28%), Services requirements (6.12%), Products Offered (1.98%), Debt Repayment (2.04%), Dividend Policy (3.10%), Financial Position (1.89%) and Centralization of supply (1.81%)

Figure 1: Relative and Cumulative Importance of Different Factors Effecting Working Capital Requirement



Conclusion

The level of requirement of working capital is varying depending on industry to industry. Each industry requires working capital and it totally refers to the working capital cycle. The working capital cycle refers to the inventory collection days into collection of cash sales. In retail sector, mostly retailers want to keep high amount of working capital as in retail inventory sale off on slow basis as they have to maintain inventory level. In retail, retailers require a low working capital because retail consumers deal on cash basis at that time they buy the product and retailers have to pay suppliers on delay basis or later. Rise of consumer demand is one of the strongest pillars behind the retail market's growth. To increased turnover and better margins, every retailer needs working capital for their business operations. Lengthy documentation, delay disbursements, high interest rates, verification by third party, collateral security are the some challenges faced by the retailers in India. Retailers has to maintain the liquidity & profitability balance to achieve effective level of WC because high investment amount in working capital leads to more liquidity with less profit as it show the inefficiency of working capital. Low investment in working capital leads to less liquid with more profitability combination leads to efficiency in working capital. Increased in working capital can lead retails to gain bargaining power, plan inventory more efficiently. While small retailers in India is more rely on cash transactions for paying rent, wages, salaries, electricity bills and for documentation. This impact the profitability as if they deposit in bank they can improve the creditworthiness of their business.

Recommendations

- Retail companies should maintain a positive working capital. Having a positive level of working capital indicates a firm with a greater potential for growth. Working capital management is a barometer that gauges the long term financial soundness of a firm and also ensures the adequate level of cash flow is maintained to meet its short term obligations. In time of uncertainty retail firms should have such type of financial protection.
- Positive working capital helps retail sector to expand, invest in new product range at a faster rate, enables retailer to fulfill customer orders, and helps to evade future hindrances, to get early payment discounts.
- Retail Company should invest in procurement automation. Periodic inventory check may help Retail Company to maintain the optimum level of stock. It helps Retail Company to save from occurrence of overstock and under stock issues.

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