

## **A Study on Working Capital Management in Textile Industry**

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### **ABSTRACT**

Textiles Industry plays a vital role in the socio-economic development of Bangladesh. But the profitability of this industry is not satisfactory. This study is designed to show the Profitability and Working Capital position of Textiles Industries, correlation between them and whether the profitability is affected by Working Capital Management. Ratio Analysis, Correlation Matrix and Regression Analysis have been used to show Profitability, Working Capital position, correlation between them and the impact of Working Capital on Profitability respectively. For the source of data the author mainly relied on Annual Reports and official records as well as primary data collected through questionnaire. It is observed from the study that profitability and Working Capital Management position of the Textiles Industry are not satisfactory. The study reveals that correlation exists between Working Capital Management and Profitability. The study also brings to fore that Working Capital Management has a positive impact on Profitability.

**Keywords:** Profitability, Working Capital Management, Textile Industry, Efficiency.

### **1. INTRODUCTION**

A financial manager in any organization has to play three functions. These functions are (i) the management of long-term assets, (ii) the management of long-term capital and (iii) the management of short-term assets and liabilities. The management of short term assets and liabilities refers to management of Working Capital (Khan, 2002). To produce the best possible returns, the firm should keep no unproductive assets and should finance with the cheapest available sources of funds. In general, it is often advantageous for the firm to invest in short-term assets and to finance with short-term liabilities. The Management of Working Capital plays an important role in maintaining the financial health of the firm during the normal course of business.

A firm is required to maintain a balance between liquidity and profitability while conducting its day to day operations. Liquidity is a precondition to ensure that firms are able to meet their short-term obligations and their continued flow can be guaranteed for a profitable venture. Working Capital Management includes maintaining optimum balance of working capital components – receivable, inventory and payables and using the cash efficiently for day-to-day operations. Optimization of working capital balance means minimizing the working capital requirement and realizing maximum possible revenues. There is a strong relationship between the firm's profitability and its working capital efficiency.

The term profitability refers to the ability of a firm to earn profit. Profit is determined by matching revenue against cost associated with it. Profit of an enterprise in absolute figure gives an idea about the result of its operation. Profitability is a widely used financial measure of performance. The concept of profitability may be used in two senses: commercial/private profitability and public

profitability. Although the use of public profitability which is based on economist's notion of cost and benefits, i.e., the true opportunity cost and the benefits for the society as a whole, appears to be a more appropriate measure of performance of public enterprises, the measure of commercial profitability has been used in this study.

This is because of the fact that commercial profitability is widely used to measure the performance of public enterprises in Bangladesh and even in other countries of the world like India, the UK, France etc. and also for its general acceptance and ready understandability.

Two major types of profitability ratios are computed: (i) Profitability in relation to sales and (ii) Profitability in relation to investment. Gross Profit Margins (GPM), Net Operating Margin (NOM), Return on Total Assets (ROTA), Return on Equity (ROE), and Return on Investment (ROI) are the main measures of profitability. Therefore, profit is an absolute measure and profitability is a relative measure of efficiency of the operations of an enterprise.

Publicly traded companies are the economic pulse of a nation. Their birth, prosperity and demise generally reflects the financial condition of the country. A fairly reliable index of an economy in its process of growth and development is the rate of growth and decline of publicly traded companies. With the rapid growth of trade, commerce and industries, the number of publicly traded companies is considerably increasing in Bangladesh. These companies play a vital role on the economy of the country. Textile is an important adjunct of industrialization in the country. Now a days textile industry is the economic pulse of Bangladesh. Its growth reflects the financial health of the country. The contribution of Textiles companies to Bangladesh economy is encouraging. The investment in this sector is increasing which indicates the potentiality of this sector. There are 39 listed Textile Companies in Dhaka Stock Exchange and 33 listed in Chittagong Stock Exchange. Analyzing the Industrial Life Cycle, it is found that all of the listed companies just have reached the middle stage. No company could yet reach the maturity stage. In a word, textile industry of the country is just improving. This sector satisfies the demand of the local market and also exports to international market. Recent evidences show that the performance of this sector is not satisfactory as compared to the performance of other manufacturing sectors. Against this backdrop an attempt has been made to examine the reasons of poor performance of textiles sector and to explore whether the poor performance is the result of poor Working Capital Management. The researcher has used correlation matrix and regression analysis to examine the relationship between profitability and working capital management. Some statistical tools like mean, standard deviation and co-efficient of variance were used to evaluate the performance.

## **2. OBJECTIVES OF THE STUDY**

The major objective of the present study is to examine and evaluate the correlation between Working Capital Management and Profitability in textile industry over a period of three years from 2006 to 2008. The specific objectives of the study are as follows

- To examine the profitability position of the selected textiles industries.
- To examine the management of cash, inventory and accounts receivable of selected textiles industries
- To assess the current liability positions and the efficiency with which the overall working capital is being managed.
- To assess the relationship between working capital management and profitability.
- To suggest some measures for improvement in working capital management.

### **3. LITERATURE REVIEW**

Extensive research works on working capital management have been done in both public and private sectors including multinational companies. Sayaduzzaman (2006) in his article on “Working Capital Management” mentions that the efficiency of working capital management, is highly satisfactory due to the positive cash inflows and planned approach in managing the major elements of working capital. He found that working capital management helps to maintain all around efficiency in operations.

In the article “Liquidity-Profitability Tradeoff: An Empirical Investigation in an Emerging Market,” examined the relation between profitability and liquidity by using correlation and regression analyses and found that the cash conversion cycle was of more importance as a measure of liquidity than the current ratio that affects profitability.

The effect of different variables of working capital management including the Average Collection Period, Inventory Turnover in Days, Average Payable Period, Cash Conversion Cycle and Current Ratio on the Net Operating Profitability of Pakistani Firms. By using Pearson’s correlation and regression analysis he found that there was a strong negative relationship between variables of Working Capital Management and Profitability. He also finds that as the cash conversion cycle increases, it leads to decrease in profitability of the firm and managers can create a positive value for the shareholders by reducing the cash conversion cycle to a possible minimum level.

A study on working capital trends of enterprises. They find that optimum working capital enables a business to have its credit standing and permits the debts payments on maturity date and helps to keep itself fairly in liquid position which enables the business to attract borrowing from the banks.

The working capital management affects profitability. He found that most firms had a large amount of cash invested in working capital. It can be expected that the way in which working capital is managed, will have a significant impact on the profitability of those firms. Using correlation and regression tests he found a significant negative relationship between corporate profitability and number of days accounts receivable, inventories and accounts payable of firms. On the basis of these he suggested that manager could increase corporate profitability by reducing the number of days accounts receivable and inventories to a reasonable minimum. The negative relationship between accounts payable and profitability is consistent with the view that less profitable firms wait longer to pay their bills.

Research study that a firm is required to maintain a balance between liquidity and profitability while conducting its day to day operations. The manager of a business entity is in a dilemma of achieving desired trade-off between liquidity and profitability in order to maximize the value of a firm.

Investigated relationship between working capital management and corporate profitability of listed companies in the Athens Stock Exchange. The results of the article showed that there was a statistically significant relationship between profitability and cash conversion cycle. Moreover managers could create profits for their companies by handling correctly the cash conversion cycle and keeping each different components (accounts receivables, accounts payables, inventory) to an optimum level.

In efficient working capital management increases firms' free cash flow, which in turn increases the firms' growth opportunities and return to shareholders. Chowdhury and Amin (2007) have written an article on "Working Capital Management Practices in Pharmaceutical Companies Listed in DSE". Among all the problems of financial management, the problems of working capital management have probably been recognized as the most crucial one. It is because of the fact that working capital always helps a business concern to gain vitality and life strength and to maximize profit.

## **4. METHODOLOGY OF THE STUDY**

Data were obtained from a sample of 9 Textiles. For the study only A and B Category Textiles were considered. Moreover, the size of the Textiles, availability of information, and year of establishment were also considered for selecting the sample Textiles. The study covered a period of three years from 2005-06 to 2007-08. This study was based on both primary and secondary data. The primary data were collected through questionnaire survey with an object to know the real practices of working capital management in Textiles. The questionnaire was divided into four parts in accordance with the major dimension of working capital management: Working Capital Management, Cash Management, Inventory Management, Accounts Receivable Management and others. The questionnaire had 41 questions, which were open and close ended in nature. Secondary time series data were taken to see the profitability and the link between profitability and working capital management. For that the published annual reports of the selected Textiles Mills Limited for the study period were considered. Moreover extensive literature survey was done by searching different libraries. The collected data were analyzed and interpreted with the help of different financial ratios, statistical tools like Mean, Standard Deviation (S.D.), Correlation Coefficient etc. With the help of SPSS, Correlation Matrix and Regression analysis were also forced out for analysis.

## **5. CONCLUSION**

Considering the coefficients and their significance level, it can be concluded that in Textiles Industry, the nature of working capital policy ( CA to Sales), financing of working capital (CL to TA), inventory holding period (Inventory Turnover in Days), Accounts Receivable Collection Period (Accounts Receivable Turnover in Days), Accounts Payable Period ( Accounts Payable Turnover in Days), and Cash Conversion Cycle in Days play an important role in determining textiles' overall profitability Return on Total Assets (ROTA). From the correlation matrix it is clear that there is positive correlation between working capital efficiency and profitability ratios of the selected textiles with some exceptions where the correlation is negative. From the profitability ratios it is clear that the performance of the selected textiles under the study period is not satisfactory. On the other hand, from the working capital ratios it is clear that the working capital position is not also satisfactory. From the regression and correlation analysis it can be concluded that the poor management of working capital is one of the important causes for poor performance or poor profitability position of the selected textiles under the study period.

Textiles play a vital role in the economic development of the country. It is found from the study that the working capital management of textiles industry is inefficient. This is evident from the study that working capital plays an important role in the overall performance of the industry. Findings from the questionnaire indicate that the sample textiles have been inefficient in managing cash, accounts receivable, inventories and accounts payables. The liquidity position of the selected

textiles is not satisfactory due to poor turnover of Current Assets, Inventory, Debtors and Cash Balances. The collection of receivables is not good due to inefficient credit and collection policy. The textiles should be cautious in formulating working capital policy.

However, in view of the concluding remarks, the following suggestions are given for increasing efficiency in working capital management as well as profitability on the basis of the analysis as well as information gathered through questionnaire:

- Monthly performance evaluation should be done as maximum textiles under the study evaluate the same.
- Inventory should be turned out quickly.
- Fund flow statement should be prepared periodically.
- Cost audit should be done continuously.
- For cash management, cash budget, cash flow statement, cost minimizing model like Baumol Model, Miller-Orr, etc. Model should be used.

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