Strategic Working Capital Management: Perspective from Balancing Profitability and Liquidity

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Abstract: Ensuring robust financial health is a crucial responsibility of a company's top management. A thorough examination and comparative analysis provide an accurate picture of the financial stability and well-being of the investors, shareholders, and creditors. This paper explores various facets of financial health analysis. In the context of global competition, the productivity of businesses hinges on identifying the new and profitable market segments. Strategic working capital management involves efficiently managing a firm's short-term assets and liabilities to ensure it maintains the right balance between profitability and liquidity. Strategies for Managing Working Capital can be in the lines of viz. Cash Management and Accounts Receivable Management, Inventory Management, Accounts Payable Management. This paper investigates the impact of working capital management on the profitability of Shree Plastic Pvt. Ltd from a real life case perspective. In this paper the authors are successfully able to justify the profitability of the firm in case, have been promising due to the proper working capital management and the strategies thereof.

Keywords: working capital, profitability, liquidity, financial health

Introduction:

Effective working capital management is essential for a firm's short-term financial health and operational efficiency (Khan et al., 2016). It involves overseeing the daily fluctuations in working capital components such as inventory, accounts receivable, and accounts payable, which are influenced by demand and supply, funding costs, and regulatory requirements (Bagchi). The primary goal of working capital management is to mitigate risks associated with these components throughout the operating cycle and to maintain a balance between them (Bagchi, n.d.). This involves optimizing the use of current assets and liabilities to increase profitability while minimizing risks. Inefficient management of working capital is a common cause of business failures, highlighting its importance for firm survival and value creation.

In today's globalized economy, multinational corporations (MNCs) are increasingly using working capital management strategies to expand internationally, acquire intangible assets, and secure capital at competitive rates (Bhattacheryay, 2023b). The manufacturing industry, in particular, faces competitive, technological, and organizational challenges but continues to drive globalization through innovative business models and international collaborations (Rycroft & Kash, 2004).

The recent economic downturn, exacerbated by trade frictions and Covid-19 pandemic, has created challenges for the manufacturing industry, leading to market volatility and affecting working capital dynamics (Mansilla-Fernández & Milgram-Baleix, 2023). Investors closely monitor factors influencing working capital management and key financial ratios to assess a firm's performance and position within the industry (Bilal Chishty et al., 2022). Understanding these factors is crucial for maintaining investor confidence and attracting investment in the automotive sector.

To provide insights into the working capital dynamics of the global manufacturing industry, this study examines the working capital management practices of Shree Plastic. The paper aims to identify profitability and liquidity of the firm.

This paper is narrated in six different segments. The next segment deals with literature review. The third segment deals with the methodology used in this study. The fourth segment deals with the analysis and the fifth segment deals with the findings and discussion. The last segment deals with conclusion and limitation of the study.

Literature Review:

Efficient working capital management is crucial for maximizing a firm's value, requiring a balance between liquidity and profitability (Bhattacheryay, 2023a). Firms must create and implement strategies tailored to their specific working capital needs to achieve this balance (Lazaridis & Tryfonidis, n.d.) Global firms face various economic and political complexities, with foreign exchange risks significantly impacting profitability, cash flows, and working capital management (Bhattacheryay, 2023a). Despite technological advancements, the manufacturing industry depends on effective working capital management due to persistent market price pressures (Zhu et al., 2007) .The manufacturing System of Toyota is recognized globally for its role in efficient working capital management (Zhu et al., 2007).

Efficient management of working capital components is critical for a firm's performance, as managers are incentivized to manage working capital effectively (Zhu et al., 2007)). Interconnected elements of working capital require careful management within a short-term cycle. Firms with higher profits often prioritize efficient working capital management, leading to increased current assets (Enqvist et al., 2014). The effectiveness of working capital management varies across industries, with the Indian automobile industry known for its aggressive approach (Rahman, 2023).

Tax differentials through transfer pricing in host countries are strategic tools for managing working capital (Sikka & Willmott, 2010). Proper working capital management is essential for a firm's profitability, liquidity, and return on equity (Lazaridis & Tryfonidis, n.d.). Success in working capital management relies on financial ratios, and supply chain partners must adapt to technological advancements to remain competitive and cost-efficient (Seth et al., 2021).

In today's globalized and integrated economy, leading multinational corporations (MNCs) internationalize their operations by acquiring intangible assets and securing capital at competitive rates (Panibratov, 2017). MNCs strategically implement working capital management policies, sourcing inputs globally, converting them into finished or semi-finished products with labour and equipment, and marketing them worldwide to generate and capture value across multiple countries (Lei, 2000).

The manufacturing industry stands out as a well-established MNC sector, holding a significant share of the global economy due to its extensive penetration in both upstream and downstream economic activities (Nolan, 2001). This industry exemplifies the competitive, technological, and organizational challenges that other industries will likely face in the future, evolving as a key driver of global economic integration (Lei, 2000). However, the manufacturing industry's internationalization strategies are increasingly challenged by time-based competition and the tight relationships among original equipment manufacturers, suppliers, and other supply chain members, including component distributors, contract manufacturers, and logistics service providers (Handfield, 1993).

While supply chain management (SCM) is crucial for the manufacturing sector, advanced technology plays a pivotal role (Lin & Tseng, 2006). These developments pressure suppliers to keep pace with technological advancements, compelling them to offer a suitable product portfolio and maintain a cost-efficient production environment (Miles, 1989). Despite these challenges, the manufacturing industry continues to generate and capture high value by adopting unique business models and merging with or acquiring foreign businesses.

Objectives of the Study:

The objectives of the study are:

- To understand the factors contributing to the financial health of a manufacturing unit with reference to Shree Plastic Pvt Ltd.,
- To make a comparative study of financial health over the last 5 years of Shree Plastic Pvt Ltd.
- To analyse the strategies adopted for the effective and efficient working capital in leveraging the firm's profitability and liquidity and
- To assess the efficiency of the organisation in managing resources.

Research Methodology:

This research aims to investigate the strategic aspects of working capital management and its impact on the balancing profitability and liquidity in "Sree Plastic PVT Ltd". Working capital management involves the management of current assets and liabilities to ensure optimal utilization of resources while maintaining adequate liquidity levels. For this analysis data has been collected from financial statements from 2018-19 to 2022-23.

Data Analysis:

Working capital represents the financial lifeline of a company, the lifeblood that keeps operations running smoothly. It is the difference between a company's current assets and its current liabilities.

Table 1: Working Capital Analysis

Year	Current Assets	Current Liabilities	Gross Working Capital	Net Working Capital
2019	58,574,151	7,903,952	58,574,151	50,670,199
2020	69,765,346	31,884,616	69,765,346	37,880,730
2021	72,021,081	1,60,65,621	72,021,081	55,955,460
2022	91,328,208	47,117,199	91,328,208	44,211,009
2023	1,15,642,068	3,02,66,661	1,15,642,068	85,375,407

Source: Annual Report of Shree Plastic Pvt Ltd

Table 1 presents the working capital analysis of Shree Plastic Pvt. Ltd from 2019 to 2023, revealing its significant growth trends. The Gross Working Capital surged from 5.85 crore in 2019 to 11.56 crore in 2023, marking a remarkable 97.43% increase over the four-year period. Conversely, the Net Working Capital witnessed fluctuations, with a notable decrease in 2020 followed by substantial rebounds in subsequent years. Despite these fluctuations, the Net WC demonstrated a compounded annual growth rate of approximately 11%, underscoring the increasing requirement for working capital within the business. It emphasizes the critical role of effective working capital management in sustaining business growth and financial stability over time. However, in 2023, there was a significant rebound with a remarkable increase of 93.11%, reaching a total of 8.53 crore. The compounded annual growth rate of net working capital is 11% (approx.). Which indicates that the requitement of working capital is increasing in the business.

Table 2: Current Ratio Analysis

Year	Current Assets	Current Liabilities	Current Ratio
2019	5,85,74,151	79,03,952	7.4
2020	6,97,65,346	3,18,84,616	2.19
2021	7,20,21,081	1,60,65,621	4.48
2022	9,13,28,208	4,71,17,199	1.94
2023	11,56,42,068	3,02,66,661	3.82

Source: Annual Report of Shree Plastic Pvt Ltd

Table 2 summarises the current ratio of Shree Plastic Pvt Ltd from 2019 to 2023. The current ratios are in the range of 1.94 (2022) to 7.4 (2019). The surge in tax provisions in 2022 stemmed from elevated debtor levels, necessitating increased provisions. Notably, current liabilities were primarily influenced by the company's additional consultancy services. Meanwhile, a boost in corporate taxes fuelled the uptick in sundry debtors. Cash and bank balances dwindled in 2022 as they were utilized for dividend payments. In 2023, loans and advances predominantly comprised of employee advances and government deposits. A reduction ensued as employees reconciled their claims, while other current assets, including interest from deposits, dwindled due to dividend declarations.

Table 3: Quick Ratio Analysis

Year	Quick Assets	Current Liabilities	Quick Ratio
2019	58,574,151	7,903,952	7.4
2020	52,470,336	31,884,616	1.65
2021	69,883,268	1,60,65,620	4.35
2022	89,433,596	47,117,199	1.9
2023	1,15,43,868	3,02,66,661	3.81

Source: Annual Report of Shree Plastic Pvt Ltd

Table 3 deals with the quick ratios of Shree Plastic Pvt Ltd between 2019-2023. The quick ratios are 7.4, 1.65, 4.35, 1.9, and 3.81 for the year 2019, 2020, 2021, 2022, and 2023 respectively. The range of quick ratios are between 7.4 to 1.65. In contrast to 2022, the quick ratio surged as sundry debtors with extended periods were excluded from quick assets. This increase was spurred by a rise in corporate tax, leading to heightened provision creation and, consequently, an augmented ratio.

Table 4: Working Capital Turnover Ratio Analysis

YEAR	Net Sales	Working Capital	Working Capital Turnover Ratio
2019	3,63,09,834	7,9,03,952	0.72
2020	5,38,99,084	3,78,80,703	1.42
2021	7,27,28,759	5,53,55,460	1.31
2022	5,55,50,649	4,42,11,009	1.26
2023	9,66,54,902	8,53,75,407	1.13

Source: Annual Report of Shree Plastic Pvt Ltd

Table 4 summarises the working capital turnover ratios. It is in the range from 0.72 to 1.42. In the recent years the working capital turnover ratio is in the same range. Due to substantial rise in income from services compared to the previous years, along with an increase in total capital employed comprising capital and reserves & surplus, has led to a significant uptick in net profit and capital employed. These factors collectively contribute to the increased ratio for the current year.

Table 5: Fixed Assets Turnover Ratio Analysis

Year	Net Sales	Net Fixed Assets	Fixed Assets Turnover Ratio
2019	36,309,834	28,834,317	1.26
2020	53,899,084	29,568,279	1.82
2021	72,728,759	17,137,310	4.24
2022	55,550,649	15,056,993	3.69
2023	96,654,902	14,163,034	6.82

Source: Annual Report of Shree Plastic Pvt Ltd

Table 5 presents the fixed assets turnover ratios of Shree Plastic Pvt Ltd. These are in the range of 1.26 to 6.82. The ratios are in an increasing trend because, the fixed assets are decreasing while, revenues are in an increasing trend. It shows that the investment in fixed assets are decreasing although the revenue are increasing.

Table 6: Status of Net profit Ratio Analysis

YEAR	NET PROFIT AFTER TAX	Income from Services	Ratio	Margin
2019	21,123,474	36,039,834	0.59	59%
2020	16,125,942	53,899,084	0.30	30%
2021	16,929,580	72,728,759	0.23	23%
2022	18,259,580	55,550,649	0.33	33%
2023	40,586,359	96,654,902	0.42	42%

Source: Annual Report of Shree Plastic Pvt Ltd

Table 6 deals with the status of net profit ratio. The margin of net profit is decreasing from 59% (2019) to 23% (2021). Then from 2021 it starts rising. A high net profit ratio can assist the firm in navigating the challenges, such as a decline in income from services, increased production costs or a decrease in demand. The rise in net profit is attributed to the increase in revenue.

Table 7: Gross Profit Margin Ratio Analysis

GROSS PROFIT MARGIN			
Year	Revenue	COGS	Margin
2019	36,039,834	14,916,360	59%
2020	53,899,084	37,773,142	30%
2021	72,728,759	55,799,179	23%
2022	55,550,649	37,291,069	33%
2023	96,654,902	56,068,543	42%

Source: Annual Report of Shree Plastic Pvt Ltd

Table 7 deals with the Gross Profit Margin Ratios. In 2019, the Gross Profit Margin of the company stood at 59%. This figure dropped significantly by approximately 29% to 30% in 2020, followed by a further decrease to 23% in 2021, representing a decline of 7%. However, there was a notable recovery in 2022 with a 10% to 33% increase. Subsequently, in 2023, there was a considerable uptick of 9% to 42%. The sharp decrease in Gross Profit Margin from 2019 to 2021 can be attributed to the impact of COVID-19 pandemic and subsequent economic lockdowns.

Table 8: Return on Investment Analysis

RETURN ON INVESTMENT			
Year	Net Profit After tax	Shareholders Fund	ROE
2019	21,123,474	67,679,219	31%
2020	16,125,942	53,301,834	30%
2021	16,929,580	70,231,061	24%
2022	18,259,580	56,473,652	32%
2023	40,586,359	97,060,013	42%

Source: Annual Report of Shree Plastic Pvt Ltd

Table 8 summarises the return-on-investment ratios from 2019 to 2023. In 2019, the Return on Equity was recorded at 31%. This figure experienced a slight decrease of 1% to 30% in 2020. However, there was a significant decline of 6% to 24% in 2021. Subsequently, there was a notable increase of 8% in 2022, bringing the Return on

Equity to 32%. Finally, in 2023, there was a substantial increase of 10%, reaching to 42%.

Table 9: Return on Assets Analysis

RETURN ON TOTAL ASSETS			
Year	**Net Profit After Tax**	**Total Assets**	**ROA**
2019	21,123,474	78,572,171	27%
2020	16,125,942	88,438,107	18%
2021	16,929,580	89,158,391	19%
2022	18,259,580	106,385,201	17%
2023	40,586,359	129,805,102	31%

Source: Annual Report of Shree Plastic Pvt Ltd

Table 9 deals with the return on assets of Shree Plastics Pvt Ltd from 2019 to 2023. In 2019, the Return on Assets stood at 27%. This figure experienced a significant decrease of 9% to 18% in 2020. However, there was a slight increase of 1% to 19% in 2021. Subsequently, there was a decrease of 2% in 2022, bringing the Return on Assets to 17%. Finally, in 2023, there was a substantial increase of 14%, reaching to 31%.

Findings and Discussion:

Various organizations exhibit different strengths and strategies, each contributing to their success. Through this study the researchers have tried to uncover several key insights of Shree Plastics Pvt Ltd. The organization maintains a robust liquidity position to navigate future challenges effectively. Its working capital remains stable, ensuring it can meet daily operational needs efficiently. Year wise, the organization consistently sets aside provisions for loans and advances, demonstrating a prudent financial management. There's a consistent upward trend in gross working capital, driven by increased investments in current assets. Notably, in 2023, the organization experienced a significant increase in net working capital compared to the preceding five years.

Conclusion:

Effective management of working capital is crucial to both financial management and top-level decision-making within a company. Successful working capital management brings out improved Liquidity which takes care of sufficient cash flow to meet its short-term obligations and operational expenses. This leads to enhanced operational efficiency by optimizing inventory levels, reducing lead times, and improving the cash conversion cycle. Because of the efficient management of receivables, payables, and inventory can reduce costs and increase profitability. Further, it effectively deals with Risk Mitigation as it helps in identifying and managing risks related to cash flow, inventory, and receivables. By efficiently managing the current assets and liabilities, the company can achieve a higher return on its investments enhancing the overall financial stability of the company, making it more attractive to investors and creditors Conducting a thorough analysis enables the management to identify areas for improvement and to implement strategies to enhance the overall performance and profitability. The company follows a traditional financing approach, relying heavily on equity for total funds and adopting a conservative stance towards working capital financing. The recommendations aim to rectify these practices and improve the company's financial structure. Furthermore, leveraging advanced technology could enhance operational efficiency and reduce operating expenses, thus contributing to overall improvement.

The study has some limitations like other studies. Firstly, the research is on a single private company's financial performance. The analysis and over all positions are recognised according to its performance. It ignores the effect of Volatility, Uncertainty, Ambiguity, and Complexity-VUCA. Further study may consider other companies with different aspects like future projects, debtor & creditor turnover ratio, operational profit margin etc. This study does not cover the inter-disciplinary aspects related to the important functions of Marketing/Sales and Human Resources. For example, effect of working capital on the customer satisfaction, sales turn over, employee attrition rate, etc. Hence, these limitations can be taken as a scope for further studies to explore them from different perspectives.

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