A

PROJECT REPORT

ON

"WORKING CAPITAL ANALYSIS"

AT

"ZENITH BIRLA (INDIA) LTD"

(Indian Tool Manufacturers Division)

SUBMITTED IN PARTIAL FULFILLMENT OF M.B.A DEGREE OF PUNE UNIVERSITY

SUBMITTED BY

(_____)

(MBA FINANCE)

PROJECT GUIDE

PROF. _____.

(INSTITUTE NAME)

2008 – 2009

ACKNOWLEDGEMENT

It is a great pleasure to me in acknowledging my deep sense of gratitude to all those who have helped me in completing this project successfully.

First of all I would like to thank Pune University for providing me an opportunity to undertake a project as a partial fulfillment of MBA degree.

Special thanks to **Mr. _____ , Mr. _____,** for providing me an opportunity to work with Zenith Birla (India) Ltd. (Indian Tool Manufacturers Division), and providing me necessary information about their organization, their operations and providing guidance in developing my project.

I greatly appreciate the staff of the surveyed business unit, who responded promptly and enthusiastically to my requests for frank comments despite their congested schedules. I am indebted to all of them, who did their best to bring improvements through their suggestions.

I would like to thank our Director and Project guide **Prof. _____** whose valuable guidance and encouragement at every phase of the project has helped to prepare this project successfully.

Finally, I would like to express my sincere thanks to my family, all the faculties, office staff, and library staff of my college and friends who helped me in some or other way in making this project.

Place: **(NAME)**

Date: / / **M.B.A (Finance)**

DECLARATION

This is to declare that I, _____, student of Management of Business Administration (20 -20), _____ have given original data and information to the best of my knowledge in the project report title **"WORKING CAPITAL ANALYSIS"** under the guidance of our Director _____ and that, no part of this information has been used for any other assignment but for the partial fulfillment of the requirement towards the completion of the said course.

I have prepared this report independently and I have gathered all the relevant information personally. I have prepared this project for **M.B.A.** for the year **20 -20** .

I also agree in principal not to share the vital information with any other person outside the organization and will not submit the project report to any other university.

Place: **(Name)**

Date: / / **M.B.A. (Finance)**

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1.1 Object of the Project

It is customary that under two years of full time course of MBA degree, a Student has to undergo different training programmes so as to establish himself capable of managing at the place of his job after the completion of the degree. One of such program is preparation of the project report, which a student has to take in joining a specific organization of choice for a specific period depending upon specialization he/she has opted for.

The main objective of carrying out this project is to know and gain practical knowledge and to know the organizations working culture.

The purpose of this project is to know the operations of the organization so as to do the thorough study. The project study also provides an opportunity to develop communication skill, analytical skill and also expose to the organizations culture and the actual working of the organization.

1.2 Selection of the Topic

The analysis of working capital is necessary for all the organization because if an organization maintains a large holding of current assets especially cash, the risk is reduced but it also reduces the profitability.

The importance of working capital management is reflected in the fact that financial managers spend a great deal of time in managing current assets and current liabilities. Arranging short term financing, negotiating favorable credit terms, controlling cash movement, managing accounts receivable and monitoring investment in inventories consume a great deal of time of financial managers. Hence, the main intention behind selecting this topic was to know the financial position of funds invested in working capital.

It was a great pleasure in studying the working capital management of Indian Tool Manufacturers Ltd. Selecting this topic has not only helped to know the financial facts but also the efficient financial management especially the various elements of working capital with the help of financial ratios of Indian Tool Manufacturers Ltd.

1.3 Objective of the study

The main objective of carrying out this project is to know and gain practical knowledge and to know the organizations working culture. The project was conducted to know the various financial and other aspects of the working capital analysis.

The present study is aimed to cover the following objectives:-

- To know the present financial position of Indian Tool Manufacturers Ltd.
- To know the working capital performance of Indian Tool Manufacturers Ltd over the past four years.
- To conduct the financial analysis on the basis of various ratios in order to understand the conditions and relationship contained in financial statements.
- To draw observations based on the study and suggest suitable measures to overcome problems or to improve its performance.

1.4 Methodology of the study

Methodology is the process of collecting the information and help to find out the solution to the topic selected by the researcher. Whereas, research helps to study and find out the techniques with proper process. It is a systematic way of presenting information.

In order to collect the required information for the project the following methods were adopted.

Primary Data

- Discussion with the General Manager (Finance) Mr. G. B. Kalro regarding the figures in the Balance sheet.
- Collection of information related to working capital from other members of the accounts department of the organization.

Secondary Data

Secondary data is provided by the organization. The needed information is collected from

- Balance sheet of Indian Tool Manufacturers Ltd as on 31st Mar 2005 to 31st Mar 2008.
- Books of Accounts of Indian Tool Manufacturers Ltd between 2005 and 2008.
- Annual Reports of Indian Tool Manufacturers Ltd between 2005 and 2008.

The present study is aimed at analyzing the working capital of Indian Tool Manufacturers Ltd by covering yearly financial data supplied in the company's financial accounts.

1.5 Scope of the study

This project is carried to analyze the working capital of Indian Tool Manufacturers Ltd for the last 4 years from 2005 to 2008.

As the part of the study of working capital and its circulation, statement of changes in working capital and ratio analysis with its conclusion and interpretation of working capital with the help of graph has been done.

This project is based on last four years record and these records are used for comparison for ratio analysis.

1.6 Limitations of the study

This project focuses only on certain factors which are important to discuss. But they cannot be discussed completely.

- The study is done on only one organization so it does not provide any scope of comparison with other organization.
- The study is based only on last five years record and do not give clear idea from the data available.
- The study is restricted to financial position of the company with no attention given to loans and advances and deposit mobilization.
- The tool of ratio analysis has certain fundamental and conceptual limitations in this project as well.
- While computing ratios, averages and percentages the figures are appropriated to two decimal places. Therefore sometimes the total may not tally.

2.1 HISTORY OF THE ORGANIZATION

(Nashik Plant)

(Aurangabad Plant)

Indian Tool Manufacturers established in 1937.

- **Pioneer in manufacture and supply of high speed steel cutting tools in India.**
- **Two Manufacturing units**
  - Nashik
  - Aurangabad
- **Certified by RWTUV**

Indian Tool Manufacturers (ITM) - A Division of Zenith Birla (India) Ltd, belonging to the Yash Birla Group, pioneered in the year 1937, the manufacture and supply of High Speed Steel Cutting Tools in India. Intensive research and development work has been an integral part of ITM's total operation on a continuous basis.

ITM Products popularly known as "Dagger Brand" made from the finest High Speed Steel and conforming to stringent international standards are now exported to the European and American Markets apart from being sold throughout India through an extensive Distribution Network.

An extensive range of High Seed Steel Cutting Tools in various grades (M2, M35, M42, & T42) and a catalogue product range of various types of Drills, an assortment of Milling Cutters, Reamers, Taps and Tool Bits are manufactured in ITM's two well equipped units in Maharashtra having ISO 9001:2000 certification. The first plant in Nashik where mainly special tools are manufactured as per customer requirement and the second plant at Aurangabad, manufacturing standard catalogue items.

ITM have established a wide marketing network of branches / resident representative / Distributors / Dealers at Ahmedabad, Bangalore, Baroda, Bhopal, Mumbai, Kolkata, Cochin, Delhi, Faridabad, Jamshedpur, Kanpur, Ludhiana, Chennai, Pune and Secunderabad.

2.2 PRODUCTS OF THE ORGANIZATION

Products	Product Range
1. Twist Drills	• Parallel Shank Twist Drills (Stub Series) • Parallel Shank Twist Drills (Jobbers Series) • Parallel Shank Twist Drills (Long Series) • Parallel Shank Twist Drills (Extra Long Series) • Taper Shank Twist Drills (With Standard Shank) • Taper Shank Twist Drills (With Oversize Shank) • Taper Shank Twist Drills (Long Series) • Taper Shank Twist Drills (Extra Long Series) • Taper Shank Core Drills • Shell Core Drills • Centre Drill Type A • Centre Drill Type B • Centre Drill Type R • Centre Drill B.S • Parallel Shank Subland Twist Drill • Taper Shank Subland Twist Drill • Taper Shank Twist Drills For Taper Pin Holes • Masonry Drills – Carbide Tipped
2. Reamers	• Parallel Hand Reamers • Long Fluted Machine Reamers • Parallel Machine Reamers • Machine Chucking Reamers With Parallel Shank • Machine Chucking Reamers With Taper Shank • Machine Jig Reamers With Taper Shank • Shell Reamers • Socket Reamers With Parallel Shank • Socket Reamers With Taper Shank • Taper Pin Hand Reamers • Taper Pin Machine Reamers • Machine Bridge Reamers • Hole Mills Unguided Type A (Roughing) • Hole Mills Guided Type B (Roughing/Finishing) • Taper Pipe Reamers
3. Milling Cutters (Bore Type)	• Cylindrical Milling Cutters • Side & Face Cutters (Straight Teeth & Staggered Teeth) • Shell End Mills • Single Angle Cutters • Double Angle Cutters

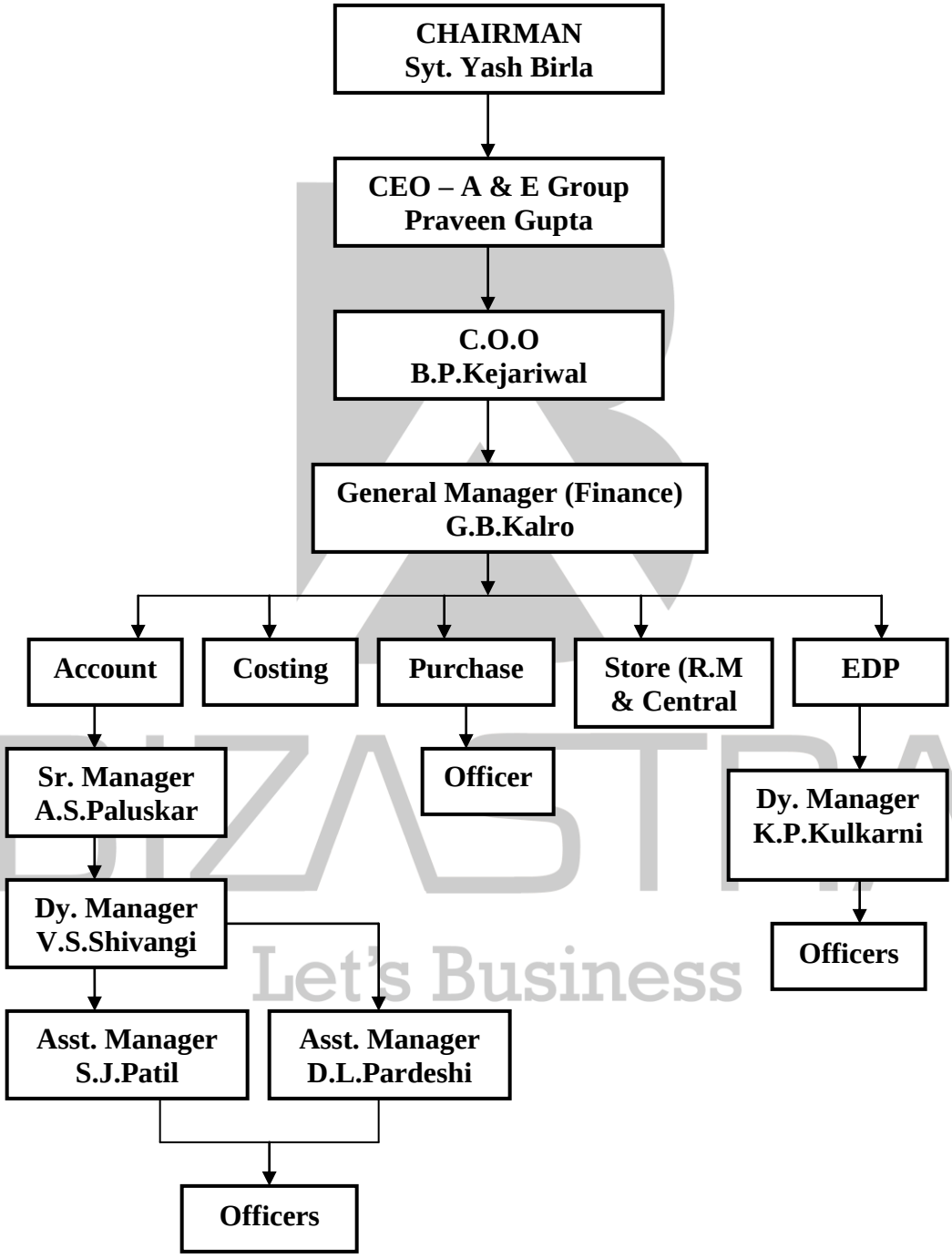
	• Equal Angle Cutters • Shell End Single Angle Milling Cutters • Face Cutters • Slotting Cutters • Keyway Milling Cutters • Hollow Mills • Convex Milling Cutters • Concave Milling Cutters • Single Corner Rounding Cutter • Double Corner Rounding Cutter
4. Milling Cutters (Shank Type)	• Parallel Shank Milling Cutter • Taper Shank Slot Milling Cutter • Parallel Shank End Mills • Screwed Shank Slot Drills Short Series, Long Series • Screwed Shank End Drills Short Series, Long Series • T' Slot Cutters With Parallel Shank • T' Slot Cutters With Taper Shank • Dove Tail Milling Cutter • Woodruff Keyslot Milling Cutter With Parallel Shank • Countersinks 90 With Parallel Shank & Solid Pilot • Countersinks 90 With Mt Shank & Detachable Pilot • Counterbores With Parallel Shank & Solid Pilot • Counterbores With Taper Shank & Detachable Pilot • Countersinks With Included Angle 60,90,&120 With Taper Shank • Countersinks With Included Angle 60 90 & 120 With Taper Shank
5.Screwing Taps	• Hand & Short Machine Taps Coarse Pitch • Hand & Short Machine Taps Fine Pitch • Hand & Short Machine Taps Coarse Pitch • Hand & Short Machine Taps Fine Pitch • Hand & Short Machine Taps BSW • Hand & Short Machine Taps BSF • Hand & Short Machine Taps UNC • Hand & Short Machine Taps UNF • Long Shank Machine Taps Coarse Pitch • Long Shank Machine Taps Fine Pitch • NUT Taps Coarse Pitch • NUT Taps - BSW • NUT Taps - BSF • NUT Taps - UNC • NUT Taps - UNF • Hand Taps – BSCY

6. Tool Bits	• Ground Tool Bits

➢ Customer Satisfaction

- ITM has well established all India marketing network of 8-Branches, 6-Resident Representatives located at major industrial consumption hubs.
- A strong network of 200 Dealers throughout the country.
- A separate "Product Development Cell" to meet special tool requirements
- ITM caters to the requirement of tools in all types industries like Automotive, Engineering, Textile, Railways, Defense and Fabrication shops.
- ITM exports to developed countries like USA, Italy, Germany, France etc.
- ITM manufactures as per customer's specific requirements in M-2, M-42 and T-42 materials.
- ITM has well established Testing Centre for manufacturing world-class tools.
- Fully integrated ERP System linking plants to branches.

2.3 ORGANIZATION CHART



3.1 INTRODUCTION

Management of working capital is one of the most significant areas in the day-to-day management of the firm. It is that functional area of finance which covers all the current accounts of the firm. It deals with management of the level of individual current assets and total working capital. Financial management means procurement of funds and its judicious use. Procurement of funds is required to finance working capital as well as fixed assets. This capital deals with different issues relating to financing and management of working capital.

3.2 DEFINITION AND MEANING

Working capital is defined as "**excess of current assets over current liabilities".** Working capital is the capital required for daily operations of the business. It comprises of current assets and current liabilities.

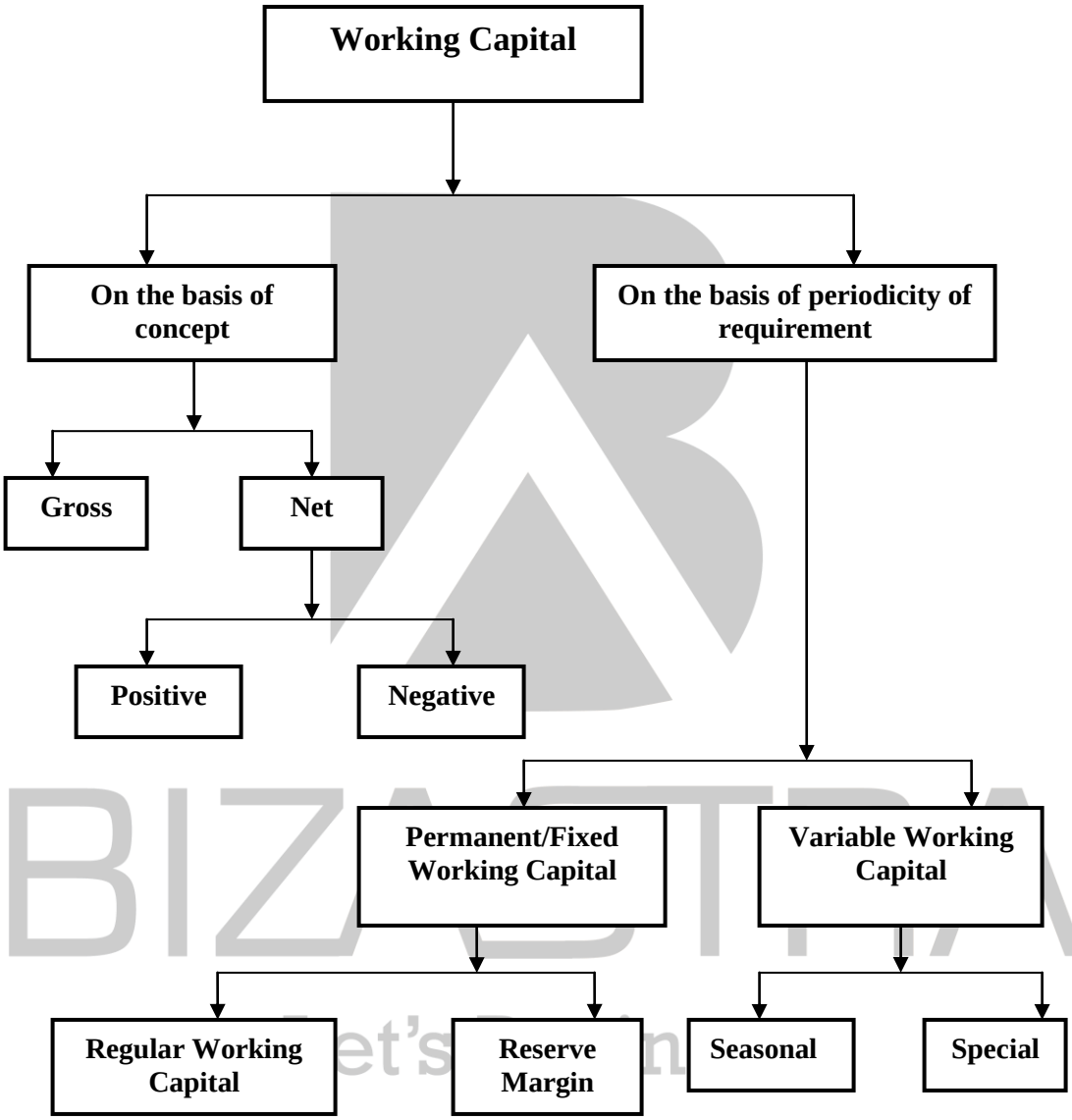
Current assets: - Those assets which can be converted into cash in the ordinary course of business without reduction in value or disrupting the operations of the firm. Current assets are essential for utilizing fixed assets profitably, e.g., a machine cannot run without raw materials. Funds invested for buying raw material are considered as working capital. Thus some funds are always blocked in raw materials, WIP, finished goods, sundry debtors, consumable stores and daily cash requirements.

Current liabilities: - Those liabilities which are incurred with the intention to be paid off within a year. E.g. Accounts payable, bills payable, bank overdraft and outstanding expenses.

The goal of working capital management is to manage the firms current assets and current liabilities in such a way that a satisfactory level of working capital is maintained. The current assets should be large enough to cover its current liabilities in order to ensure a reasonable martin of safety.

The interaction between current assets and current liabilities is the main theme of working capital.

3.3 CLASSIFICATION OF WORKING CAPITAL



A) Working capital from the point of view of concept

There are two concepts of working capital i.e., gross and net.

Gross Working Capital means total of investments in all current assets.

Net Working Capital (NWC) means excess of total current assets over total current liabilities. Another definition of NWC is that portion of current assets which is financed with long-term funds. Current liabilities means those liabilities which are payable within a period of 1 year, out of the current assets or earnings of the concern. Examples of current liabilities are accounts payable, ills payable, bank overdraft and outstanding expenses.

Net Working Capital = Current assets – Current liabilities

Negative Working Capital: - When current liabilities are more than current assets there is negative working capital. Such firms have problem of liquidity and difficulty in making payments.

Zero Working Capital: - Companies maintain current liabilities just equal to the current assets. So the working capital is zero.

B) Working capital from the point of view of time

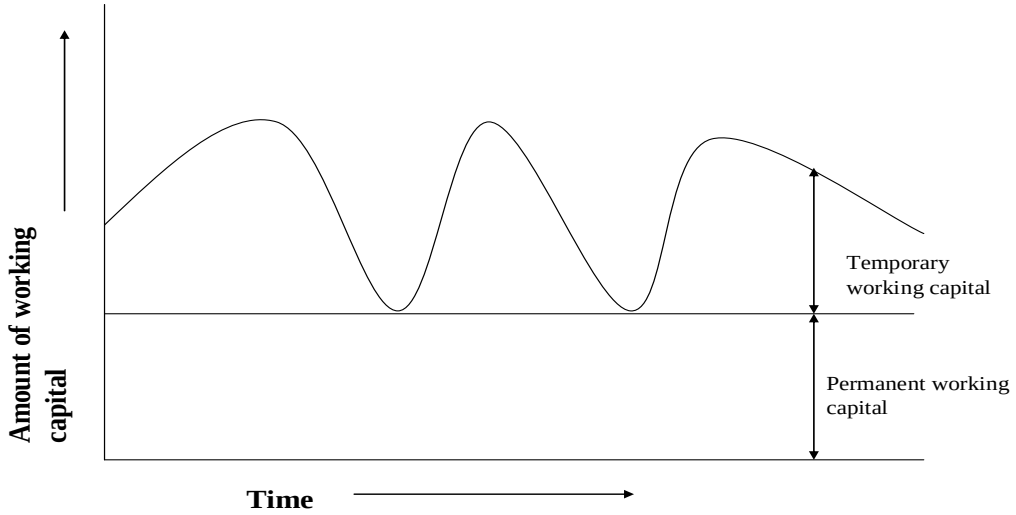
There are two categories of working capital i.e., Permanent and temporary.

Business activity do not cease with the realization of cash from customers. It continues and hence there is continuous requirement of working capital. However, the magnitude of working capital needed is not constant, but fluctuating.

Permanent or fixed working capital: - It refers to the hard core working capital. It is the minimum level of investment in the current assets which is carried by the business at all times to carry on its minimum level of activities.

Temporary or variable working capital: - It refers to that portion of the total working capital which is needed by a business over and above the permanent working capital. This working capital is required to meet the fluctuations in demand due to changes in production and sales as a result of seasonal changes. Since the volume of temporary working capital is constantly fluctuating from time to time depending on business activities, it may be financed from short term sources.

The basic difference between permanent and temporary working capital is shown in the following fig.



3.4 DETERMINANTS OF WORKING CAPITAL

The total working capital requirement of a firm depends on a wide variety of factors. These factors vary from time to time and affect different enterprises differently. Some of these factors are:

1) **General nature of business :**

The type of business could influence the quantum of working capital:

(a) Service Industry:- Least amount of working capital because of no inventories and mostly cash sales

(b) Trading enterprise: - Working capital level is reduced because no manufacturing expenses, stock of raw material and work in progress.

(c) Manufacturing enterprise: - Largest amount of working capital because of blockage of funds in assets.

2) **Production cycle :**

Depending on the technology, if the time required to convert raw material into finished goods is long, working capital requirement would increase. E.g.:- Durable goods.

3) **Business cycles :**

Business fluctuations lead to cyclical and seasonal changes in production and sales which affect the requirements of working capital. Larger working capital during boom period in economy whereas during recession activities decline, hence working capital also decreases.

4) **Seasonal Variations :**

Seasonality factor creates production and storage problem. If production in peak season only, working capital required for maintaining working force and physical facilities throughout the year. If there is steady production policy working capital required for maintaining large stocks.

5) **Inventory Policy :**

The inventory policy of a company greatly influences the working capital requirements as huge amount of funds is usually locked up in inventories. An efficient firm may keep raw material for a smaller period and hence require smaller amount organization working capital.

6) **Credit Policy :**

(a) Credit granted to customer: - If it is liberal, larger working capital due to increase in debtors.

(b) Credit from suppliers: - If liberal, current liabilities increases and working capital decreases.

7) **Growth & Expansion :**

When company grows it requires larger amount of working capital to finance the period from starting operations to achieving sales. However, the growth in industries may not directly vary with the growth in working capital. Growth industries normally need more working capital than those which are static.

8) **Problems in raw material availability :**

Irregular supply of raw material or source at long distance leads to firms keeping larger stock of raw material which increases working capital.

9) **Inflation :**

During inflation, raw material prices increase due to which working capital increases because company cannot immediately increase the price of their final product.

10) **Profit level :**

The levels of profits earned vary from firm to firm. It is determined by the nature of the product, hold on the market, monopoly power, quality of management, etc. Large profit margins, low working capital therefore profits are available for payments.

11) **Dividend policy :**

The payment of dividend utilizes cash resources which affects working capital. Again, if a firm retains its profit, it will increase its working capital. Thus in working capital requirement planning it is to be decided whether profits will be retained or paid to shareholders.

3.5 ADVANTAGES OF WORKING CAPITAL

Working capital should be adequate for smooth running of the operations and uninterrupted flow of product.

Both the inadequate and excessive working capital is dangerous. If the working capital is inadequate the production will suffer. Low liquidity and low production may lead to low profitability which in turn affects the liquidity.

If the working capital is excessive, excessive inventory is main target. It results in the operational inefficiency leading to low profitability.

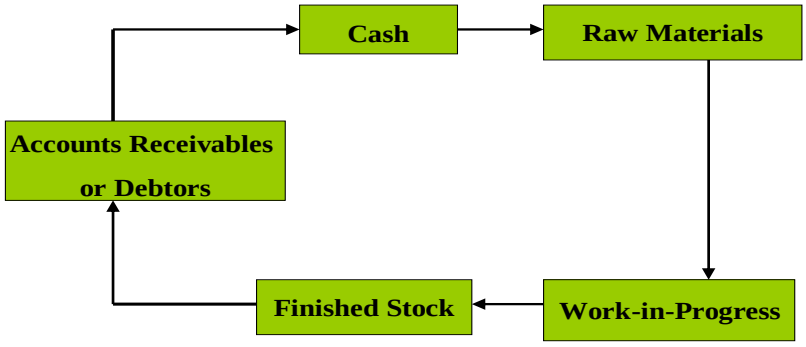
- Adequate working capital enables a firm to avail cash discount facilities offered to it by the supplier as the amount of cash discount reduces the cost of purchase.
- Adequate working capital enables a firm to make prompt payment, which creates and maintain goodwill.
- It facilitates to meet situation of crisis and emergencies and enables business to withstand periods of depression smoothly.
- Adequate working capital helps in increasing profits as purchasing requirements in bulk when prices are lower and holding its inventories for higher period.
- Sufficient amount of working capital helps in research programmes, innovations and technical development.
- Adequate working capital enables a concern to pay regular dividends to its investors, which gains confidence in minds of investors and this situation creates a favorable market to raise additional funds in the future.
- Adequate working capital creates an environment of security, confidence, high morale etc and creates overall efficiency in business.

3.6 PROBLEMS FACED BY INADEQUATE WORKING CAPITAL

- In case of inadequate working capital, firm may not be able to take advantage of cash discount.
- It may not be able to take advantage of profitable business opportunities.
- It may fail to pay dividend because of non-availability of funds.
- Short term liabilities cannot be paid because of inadequate working capital, which leads to borrow funds at exorbitant rates of interest.
- Fixed assets cannot effectively and efficiently be utilized on account of lack of sufficient working capital.
- Its low liquidity position may lead to liquidation of firm thus it may lose its reputation therefore a firm may not be able to get credit facilities.

3.7 CONCEPT OF OPERATING CYCLE

If the objective is to maximize shareholders wealth, then sufficient profit is to be generated through successful sales program. But sales are not converted into cash instantly. There is a time gap between sale of goods and realization of cash. Working capital in the form of current assets is required to carry on sales activities during this time gap. The cycle refers to the time gap between the firms paying cash for raw material, taking up production, building up stock and inflow of cash from debtors (sales). A company can procure some amount of raw materials on credit, but it has to pay for the other portion of raw material, labour costs and factory overheads. The combination of this three is called WIP. On completion of the production cycle WIP is converted into finished product, which when sold on credit is converted into sundry debtors. On expiry of credit period cash is realized from sundry debtors. This cash can be re-used for financing raw materials, WIP, etc. Hence there is a complete cycle from cash to cash, i.e. cash is converted into raw materials, WIP, finished products, debtors and cash again. The requirement of funds during this time gap is met by short-term funds. This cycle is called as **'Working Capital Cycle or Cash Cycle'**. The continuing flow from cash to supplier, to inventory, to accounts receivables and back into cash is what is called the operating cycle.



Operating cycle shows the length of time between a co.'s paying for raw materials, entering into stock and realizing the cash from sales of finished products. The

Length of the time can be calculated by adding the number of days needed for each stage in the cycle.

The operating cycle comprises of the following events :

1. Conversion of cash into raw materials;
2. Conversion of raw materials into work in progress (WIP);
3. Conversion of WIP into finished products;
4. Conversion of finished product into debtors through sales; and
5. Conversion of debtors into cash.

Therefore,

Operating Cycle = Inventory Period + Accounts Receivables Period.

Cash Cycle = Operating Cycle – Accounts Payable Period.

a) Inventory Period = Average Inventory / Annual COGS / 365

b) Accounts Receivables Period = Average A/cs Receivables / Annual Sales / 365

c) Account Payable Period = Average A/cs Payable / Annual COGS / 365

COMPUTATION OF OPERATING CYCLE FOR THE PERIOD 2007-2008

a)	Inventory Period	220,958,370 / 573,924,740 / 365	141 days
b)	Accounts Receivable Period	164,265,710 / 688,510,180 / 365	87 days
c)	Accounts Payable Period	103,040,660 / 573,924,740 / 365	66 days

Operating Cylcle = 141 + 87

= **228 days**

Cash Cycle = 228 – 66

= **162 days**

3.8 STATEMENT SHOWING CHANGES IN WORKING CAPITAL

CHANGES IN WORKING CAPITAL FOR THE YEAR 2005-2006

Particulars	Year 2005	Year 2006	Increase in working capital	Decrease in working capital
A) Current Assets				
1. Inventories	145,055,690	209,362,420	64,306,730	----
2. Sr. Debtors	78,174,370	124,427,790	46,253,420	----
3. Cash and Bank Balance	16,112,330	22,789,560	6,677,230	----
4. Loans & Advances	24,469,440	25,207,640	738,200	----
B) Current Liabilities				
1. Sr. Creditors due to Small Scale Industries	1,044,280	474,060	570,220	----
2. Other than SSI				
3. Advances from customers	65,810,670	58,260,410	7,550,260	----
4. Other liabilities	2,240,400	1,456,080	784,320	----
5. Central Excise Duty Payable	6,615,850	17,635,680	----	11,019,830
6. Provision for Gratuity	9,900,480	27,047,760	----	17,147,280
7. Provision for Privileged Leave	21,848,920	25,959,620	----	4,110,700
	8,294,390	10,196,530	----	1,902,140
			126,880,380	**34,179,950**

Net Increase in Working Capital = 92,700,430

Comment:-

It shows net increase in working capital because of tremendous increase in inventories & debtors even though central excise duty has been paid.

CHANGES IN WORKING CAPITAL FOR THE YEAR 2006-2007

Particulars	Year 2006	Year 2007	Increase in working capital	Decrease in working capital
A) Current Assets				
1. Inventories	209,362,420	196,260,090	----	13,102,330
2. Sr. Debtors	124,427,790	146,209,160	21,781,370	----
3. Cash and Bank Balance	22,789,560	45,120,200	22,330,640	----
4. Loans & Advances	25,207,640	24,969,520	----	238,120
B) Current Liabilities				
1. Sr. Creditors due to Small Scale Industries	474,060	500,600	----	26,540
2. Other then SSI	58,260,410	68,474,550	----	10,214,140
3. Advances from customers	1,456,080	462,640	993,440	----
4. Other liabilities	17,635,680	24,896,430	----	7,260,750
5. Central Excise Duty Payable	27,047,760	16,451,990	10,595,770	----
6. Provision for Gratuity	25,959,620	28,115,900	----	2,156,280
7. Provision for Privileged Leave	10,196,530	11,469,580	----	1,273,050
			55,701,220	**34,271,210**

Net Increase in Working Capital = 21,430,010

Comment:-

As compared to 2005-2006, Indian Tool Manufacturers has controlled their working capital by decreasing inventories & recovering debtors to some extent. On the other hand they increased creditors by raising average payment period & other liabilities.

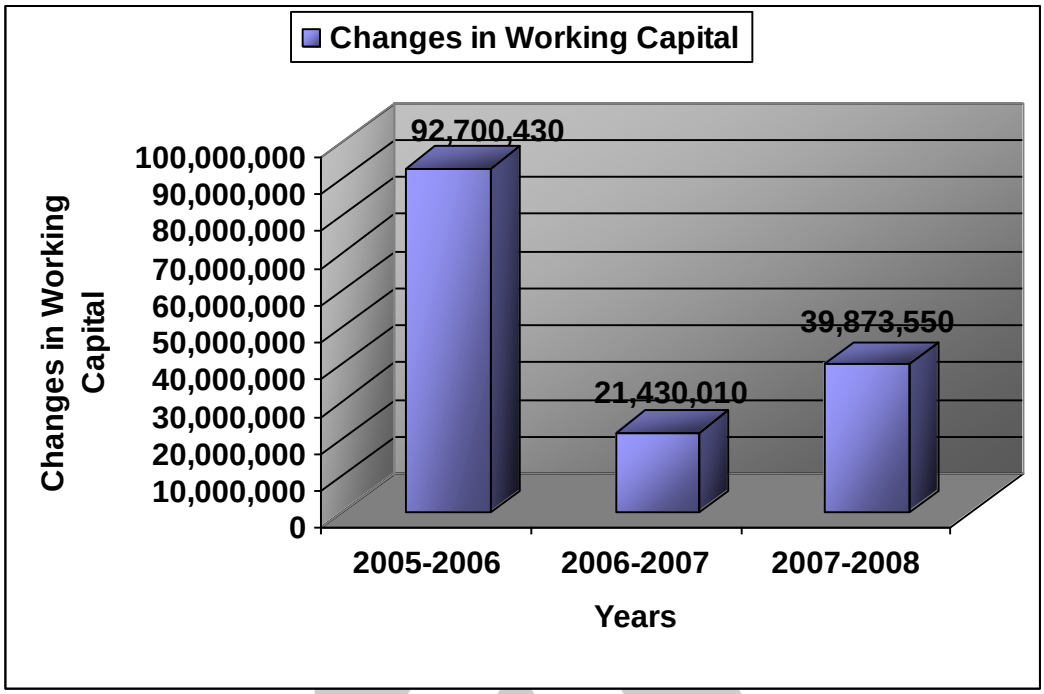
CHANGES IN WORKING CAPITAL FOR THE YEAR 2007-2008

Particulars	Year 2007	Year 2008	Increase in working capital	Decrease in working capital
A) Current Assets				
1. Inventories	196,260,090	245,656,650	49,396,560	
2. Sr. Debtors	146,209,160	182,322,260	36,113,100	
3. Cash and Bank Balance	45,120,200	47,291,570	2,171,370	
4. Loans & Advances	24,969,520	55,137,190	30,167,670	
B) Current Liabilities				
1. Sr. Creditors due to Small Scale Industries	500,600	619,380		118,780
2. Other then SSI	68,474,550	136,486,780		68,012,230
3. Advances from customers	462,640	237,740	224,900	
4. Other liabilities	24,896,430	39,028,150		14,131,720
5. Central Excise Duty Payable	16,451,990	8,670,680	7,781,310	
6. Provision for Gratuity	28,115,900	30,676,150		2,560,250
7. Provision for Privileged Leave	11,469,580	12,627,960		1,158,380
			125,854,910	**85,981,360**

Net Increase in Working Capital = 39,873,550

Comment:-

There is again net increase in working capital as compared to last year because of increase in current assets, loans & advances. More stock is maintained & loans & advances are given to employees.



Comment:-

The firm had better utilization of working capital in the year 2005-2006 as compared to rest of the years. The firm should give proper attention towards utilization of working capital. It has reduced in 2006-2007 and again there is net increase in2007-2008, which shows that that they must have increased their current liabilities and tried to keep current assets at a level set by the firm. Thus, Indian Tool Manufacturers has a sufficient Net Working Capital to meet the claims of creditors and day to day needs of business.

4.1 INTRODUCTION TO FINANCIAL STATEMENTS

The financial statements of the business firm includes

1. Trading Account
2. P & L Account
3. Balance sheet

The financial statement provides summarized view of the financial position and operations organization of the firm therefore; much can be learnt about a firm from a careful examination of its financial statements as invaluable documents/ performance reports. The analysis of financial statement is thus, an important aid to financial analysis. This is necessary to find out the realistic picture of the business. This is also necessary to analyze the business from various angles like liquidity, profitability, solvency etc.

4.2 DEFINITION AND MEANING OF RATIO ANALYSIS

Ratio analysis is widely used tool of financial analysis. It is defined as **"the systematic use of ratio to interpret the financial statements so that the strength and weakness of a firm as well as its historical performance and current financial condition can be determined."**

Ratio analysis is one of the powerful tools of financial statement analysis. A statement indicates a quantitative relationship between the figures and groups of figures which can use for evaluation and decision making. The ratios reveal the relationship in more meaningful way so as to enable us to draw conclusions from them. They enable analyst to draw conclusions regarding financial position.

4.3 IMPORTANCE OF RATIO ANALYSIS

As a tool of financial management, ratios are of crucial significance. The importance of ratio analysis lies in the fact that it presents facts on comparative basis and enables the drawing of inferences regarding the performance of a firm. Ratio analysis is relevant in assessing the performance of a firm in respect of the following aspects:

1. **Liquidity Position:**

With the help of ratio analysis conclusions can be drawn regarding the liquidity position of a firm. The liquidity position of a firm would be satisfactory if it is able to meet its current obligations when they become due. A firm can be said to have the ability to meet its short-term liabilities if it has sufficient liquid funds to pay the interest on its short-maturing debt usually within a year as well as to repay the principal. The liquidity ratios are particularly useful in credit analysis by banks and to the suppliers of short-term loans.

2. **Long-term Solvency:**

Ratio analysis is equally useful for assessing the long-term financial viability of a firm. This aspect of the financial position of a borrower is of concern to the long-term creditors, security analysts and the present and potential owners of a business. The long-term solvency is measured by the leverage/capital structure and profitability ratios which focus on earning power and operating efficiency.

3. **Operating Efficiency:**

It throws light on the degree of efficiency in the management and utilization of its assets. The various activity ratios measure this kind of operational efficiency. In fact, the solvency of a firm is, in the ultimate analysis, dependent upon the sales revenues generated by the use of its assets – total as well as its components.

4. **Overall Profitability:**

The management is constantly concerned about the overall profitability of the enterprise. That is, they are concerned about the ability of the firm to meet its short-term as well as long-term obligations to its creditors, to ensure a reasonable return to its owners and secure optimum utilization of the assets of the firm. This is possible if an integrated view is taken and all the ratios are considered together.

5. **Inter-firm Comparison:**

Ratio analysis not only throws light on the financial position of a firm but also serves as stepping stone to remedial measures. This is made possible due to inter-firm comparison and comparison with industry averages. Inter-firm comparison is necessary to find out the exact position of a firm as compared to other firms in the same industry. Intra-firm comparison is also necessary to compare the performance of a firm of a current year with that of previous year.

6. **Trend Analysis:**

Finally, ratio analysis enables a firm to take the time dimension into account. In other words, whether the financial position of a firm is improving or deteriorating over the years. This is made possible by the use of trend analysis. The significance of a trend analysis of ratios lies in the fact that the analysts can know the direction of movement, that is, whether the movement is favorable or unfavorable.

4.4 ADVANTAGES OF RATIO ANALYSIS

Ratio analysis helps management pin point specific areas that reflect improvement or deterioration as well as detect any trouble spots that may prevent the attainment organization of objective. The interested parties undertake frequently examination of these three areas to evaluate management's ability to maintain a satisfactory balance among them; and to appraise the efficiency and effectiveness with which management directs the firms operations. Thus, the purpose of ratio analysis is to help the reader of accounts, understand the information shown by highlighting a number of key relationships. However, the following are the principal advantages claimed by ratio analysis:

- It guides management in formulating future financial planning and polices.
- It throws light on the efficiency of business organization.
- It permits comparison of the firms figures with data for similar firms, and possibly with industry wise data. And it permits the data to be measured against yard stick of performance or of sound financial conditions.
- It ensures effective cost control.
- It provides greater clarity, perspective or meaning to data and it brings out information not otherwise apparent.
- It measures profitability and solvency of a concern.
- It permits monetary figures of many digits to be condensed to two or three digits which enhance the managerial efficiency.
- It helps in investment decisions.

4.5 LIMITATIONS OF RATIO ANALYSIS

Ratio analysis is a widely used tool of financial analysis. Yet, it suffers from various limitations. The operational implication of this is that while using ratios, the conclusions should not be taken on their face value. Some of the limitations which characterize ratio analysis are:

- Ratios are calculated from financial statements which are affected by the financial bases and policies adopted on such matters as depreciation and the valuation of stocks.
- Financial statements do not represent a complete picture of the business, but merely a collection of facts which can be expressed in monetary terms. These may not refer to other factors which affect performance.
- Over use of ratios as controls on managers could be dangerous, in that management might concentrate more on simply improving the ratios than on dealing with the significant issues. For e.g., the return on capital employed can be improved by reducing assets rather than increasing profits.
- A ratio is a comparison of two figures, a numerator and denominator. In comparing ratios it may be difficult to determine whether differences are due to changes in the numerator, or in the denominator or in both.
- Ratios are inter-connected. They should not be treated in isolation. The effective use of ratios therefore, depends on being aware of all these limitations and ensuring that, following comparative analysis, they are used as a trigger point for investigation and corrective action rather than being treated as meaningful in themselves.
- The analysis of ratios clarifies trends and weaknesses in performance as guide to action as long as proper comparisons are made and the reasons for adverse trends or deviations from the norm are investigated thoroughly.

4.6 CALCULATION OF RATIOS

A) Liquidity Ratios

B) Turnover Ratios

A) LIQUIDITY RATIOS

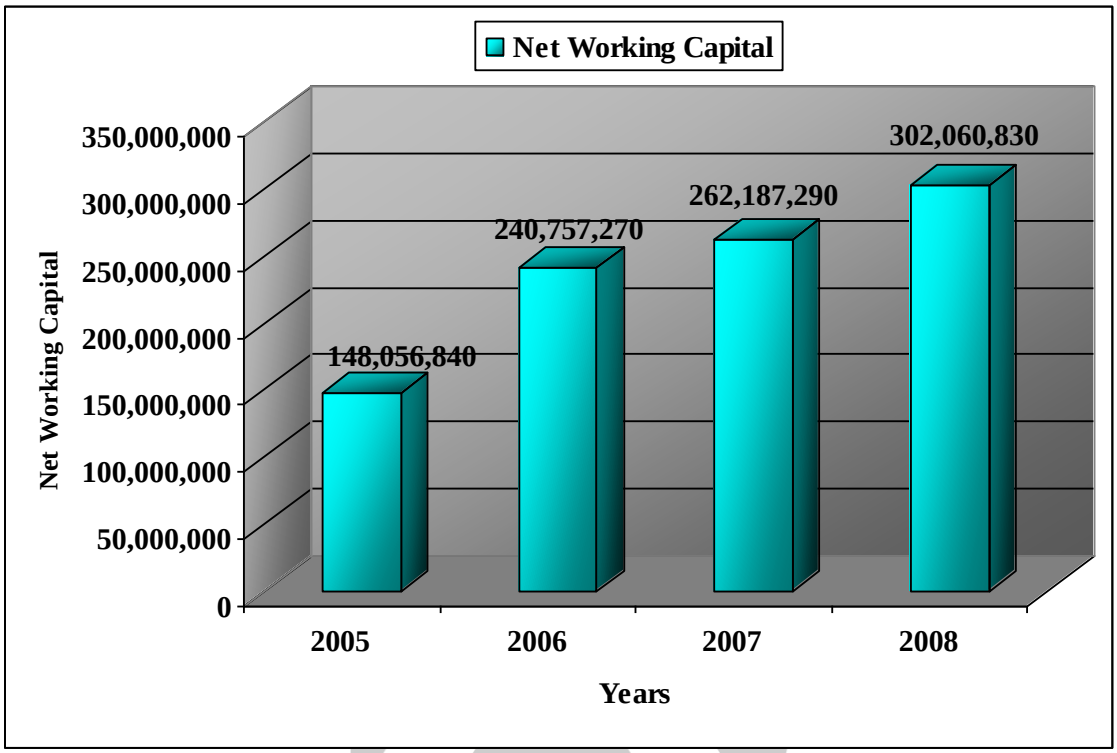
The importance of adequate liquidity in the sense of the ability of a firm to meet current / short-term obligations when they become due for payment can hardly be overstressed. In fact, liquidity is a prerequisite for the very survival of a firm. The short-term creditors of the firm are interested in the short-term solvency or liquidity of a firm. But liquidity implies, from the view point of utilization of the funds of the firm, the funds are idle or they earn very little. A proper balance between the two contradictory requirements, that is, liquidity and profitability, is required for efficient financial management. The liquidity ratios measure the ability of a firm to meet its short-term obligations and reflect the short-term financial solvency of a firm.

1. NET WORKING CAPITAL (NWC)

Net Working Capital represents the excess of current assets over current liabilities. Although NWC is really not a ratio, it is frequently employed as a measure of company's liquidity position. An enterprise should have sufficient NWC in order to be able to meet the claims of the creditors and the day-to-day needs of business. The greater is the amount of NWC the greater is the liquidity of the firm.

Net Working Capital = Current Assets – Current Liabilities

Year	Current Assets – Current Liabilities	NWC
2005	**263,811,830-115,754990**	**148,056,840**
2006	**381,787,420-141,030,150**	**240,757,270**
2007	**412,558,980-150,371,690**	**262,187,290**
2008	**530,407,680-228,346,850**	**302,060,830**



Comment:-

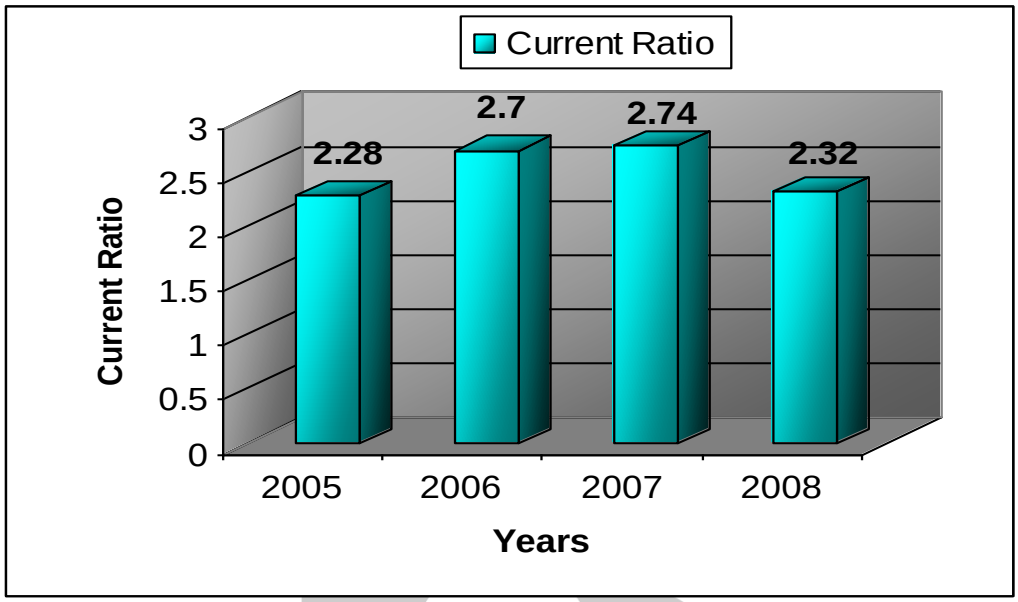
The Net Working Capital of the firm is showing an increase in each year, which indicates that Indian Tool Manufacturers Ltd. has a sufficient Net Working Capital to meet the claims of creditors and day to day needs of business.

2. CURRENT RATIO

The current ratio is the ratio of total current assets to total current liabilities. It is calculated by dividing current assets by current liabilities. The current ratio of a firm measures its short-term solvency, that ism its ability to meet short-term obligations. ***The higher the current ratio, the larger is the amount of rupees available per rupee of current liability, the more is the firm's ability to meet current obligations and the greater is the safety of funds of short-term creditors.*** Thus, current ratio, in a way, is a measure of margin of safety to the creditors.

$$\textbf{Current Ratio} = \frac{\textbf{Current Assets}}{\textbf{Current Liabilities}}$$

Year	Current Assets / Current Liabilities	Current Ratio
2005	263,811,830 / 115,754990	2.28
2006	381,787,420 / 141,030,150	2.70
2007	412,558,980 / 150,371,690	2.74
2008	530,407,680 / 228,346,850	2.32



Comment:-

The Current Ratio of a firm measures its short-term solvency, its ability to meet short-term obligations. The higher the current ratio i.e **more than 2:1** indicated sound solvency position, the more is the firms ability to meet current obligation and the greater is the safety of funds of short-term creditors and lower ratio i.e **less than 2:1** indicate inadequate working capital.

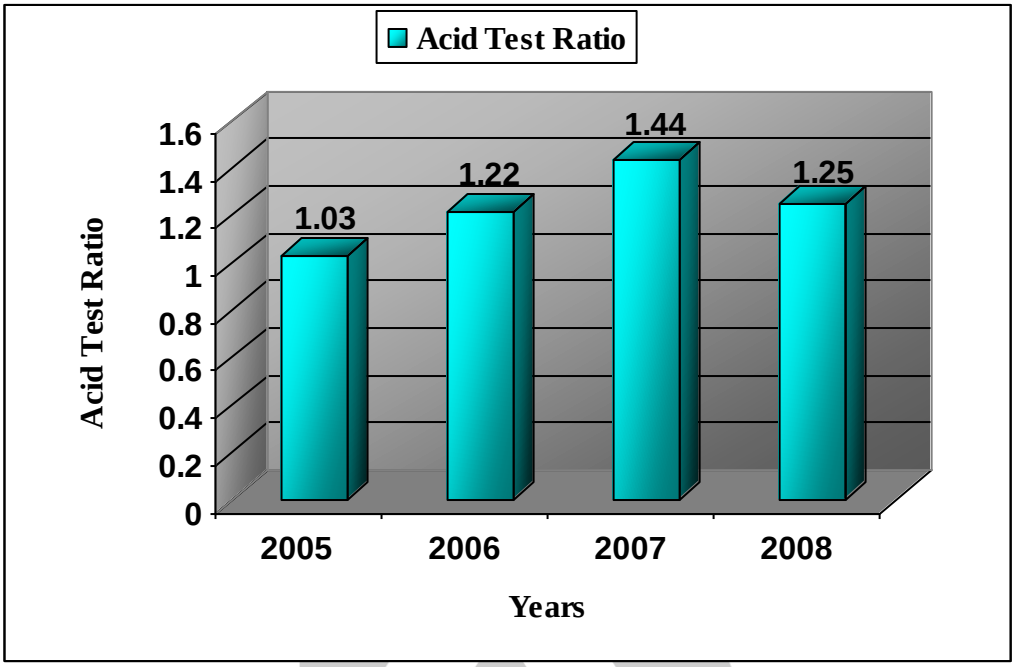
Indian Tool Manufacturers Ltd. has improved its current ratio, which is more than 2:1. Hence, it is able to meet its obligations and for the creditors the firm is less risky.

3. ACID TEST / QUICK RATIO

The acid test ratio is a measure of liquidity designed to overcome the defect of current ratio. It is often referred to as quick ratio because it is a measurement of firm's ability to convert its current assets quickly into cash in order to meet its current liabilities. Thus, it is a measure of quick or acid liquidity. The acid-test ratio is the ratio between quick current assets and current liabilities and is calculated by dividing the quick assets by the current liabilities.

Acid Test Ratio = Current Assets – Stock
Current liabilities –O/D

Year	CA – Stock / CL - O/D	Acid Test Ratio
2005	263,811,830 – 145,055,690 / 115,754990	1.03
2006	381,787,420 – 209,362,420 / 141,030,150	1.22
2007	412,558,980 – 196,260,090 / 150,371,690	1.44
2008	530,407,680 – 245,656,650 / 228,346,850	1.25



Comment:-

Acid Test Ratio indicates the firms ability to convert its current assets quickly into cash in order to meet its current liabilities. Higher ratio i.e **more than 1:1** indicates sound financial position and lower ratio i.e **less than 1:1** indicates financial difficulty.

Thus from the above graph we can see that Indian Tool Manufacturers Ltd. acid test ratio is more than 1:1. Thus it has a sound financial position.

B) TURNOVER RATIOS

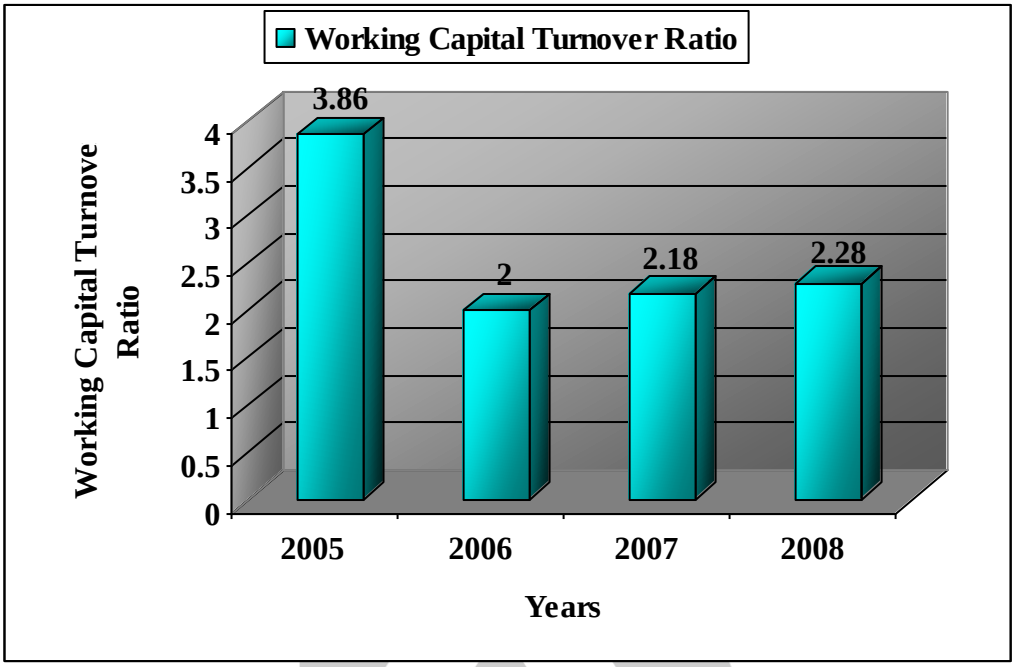
Another way of examining the liquidity is to determine how quickly certain current assets are converted into cash. The ratios to measure these are referred to as turnover ratios.

1. WORKING CAPITAL TURNOVER RATIO

This ratio is also known as 'Inventory Turnover Ratio'. It is indicated by sales divided by net working capital. The indication given by this ratio is the number of times working capital is turned around in particular period.

$$\textbf{Working Capital Turnover Ratio} = \frac{\textbf{Sales}}{\textbf{NWC}}$$

Year	$\frac{\text{Sales}}{\text{NWC}}$	Working Capital Turnover Ratio
2005	$\frac{571,118,380}{148,056,840}$	3.86
2006	$\frac{482,553,300}{240,757,270}$	2.00
2007	$\frac{570,499,580}{262,187,290}$	2.18
2008	$\frac{688,510,180}{302,060,830}$	2.28



Comment:-

The higher the ratio the better is the utilization of the working capital as well as lower inventory in working capital.

Indian Tool Manufacturers Ltd had higher ratio of 3.86 in the year 2005 but it declined to 2 in 2006 which shows higher inventory in working capital. It shows the increasing trend after 2006. The firm had better utilization of working capital in the year 2005 as compared to rest of the years. The firm should give proper attention towards utilization of working capital.

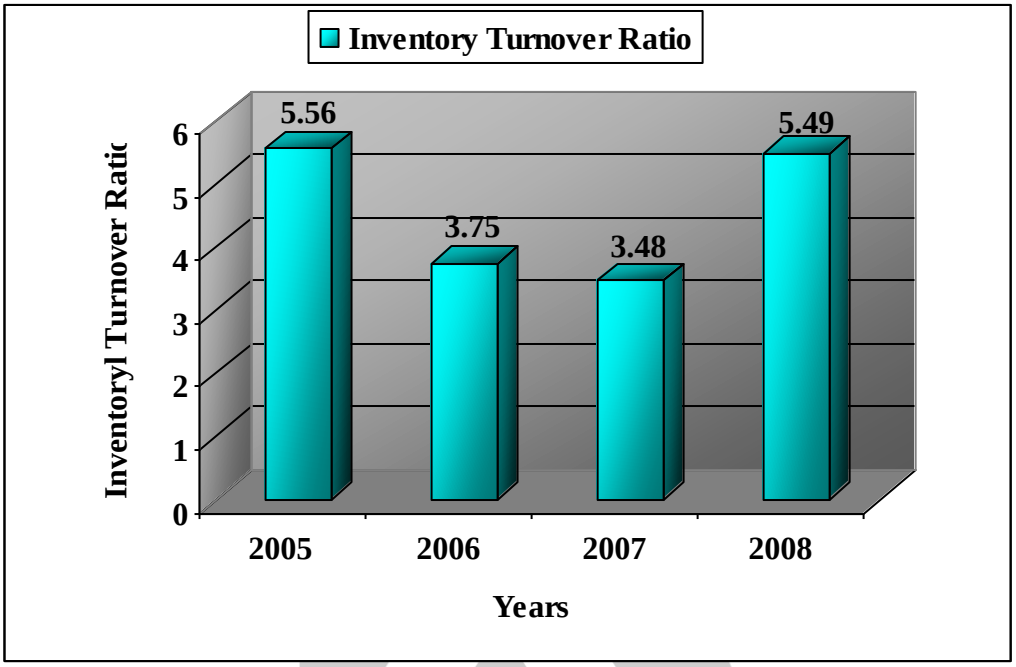
2. INVENTORY TURNOVER RATIO

It is computed by dividing the cost of goods sold by the average inventory. The ratio indicates how fast inventory is sold. A high ratio is food from the viewpoint of liquidity and vice versa. A low ratio would signify that inventory does not sell fast and stays on the shelf or in the warehouse for a long time.

$$\textbf{Inventory Turnover Ratio} = \frac{\textbf{Cost of Goods Sold}}{\textbf{Average Inventory}}$$

$$\textbf{Average Inventory} = \frac{\textbf{Opening Stock} - \textbf{Closing Stock}}{\textbf{2}}$$

Year	Cost of Goods Sold / Average Inventory	Inventory Turnover Ratio
2005	457,329,780 / 82,234,860	5.56
2006	417,109,460 / 111,362,160	3.75
2007	416,594,790 / 119,845,730	3.48
2008	573,924,740 / 104,483,940	5.49



Comment:-

This rate measures how quickly inventory is sold. It is a test of efficient inventory management. A high inventory turnover ratio is better than a low ratio.

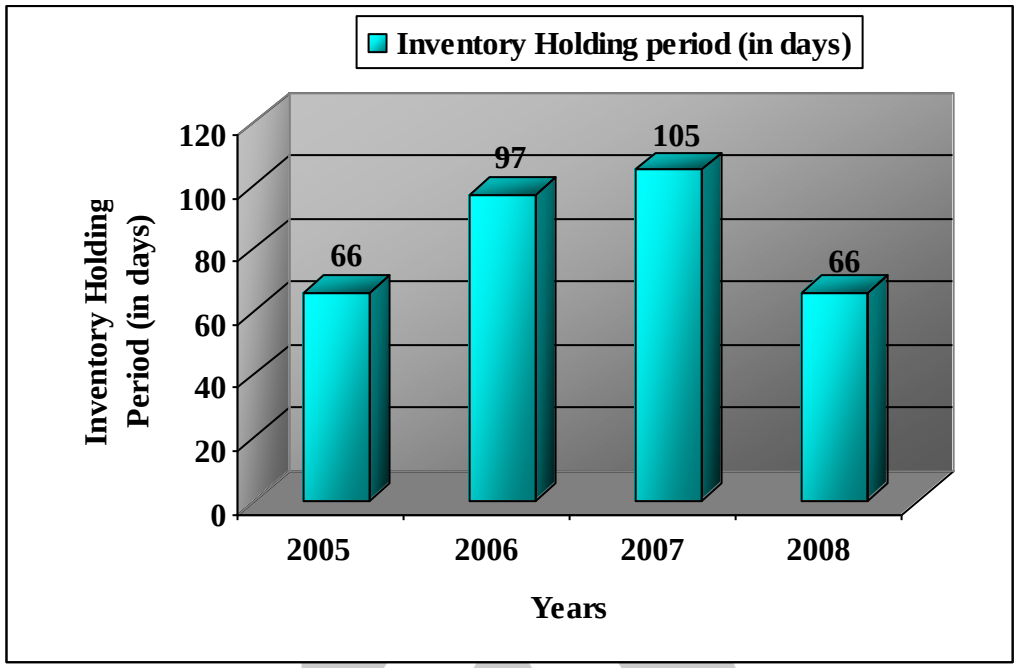
Indian Tool Manufacturers Ltd. ratio shows that inventory is moving fast and does not remain in warehouse for long period of time. The years 2005 and 2008 shows high inventory turnover ratio.

3. INVENTORY HOLDING PERIOD

Inventory holding period shows whether the inventory is moving fast or not.

$$\textbf{Inventory Holding Period} = \frac{365}{\text{Stock Turnover Ratio}}$$

Year	$\frac{365}{STR}$	Inventory Holding Period
2005	$\frac{365}{5.56}$	66 days
2006	$\frac{365}{3.75}$	97 days
2007	$\frac{365}{3.48}$	105 days
2008	$\frac{365}{5.49}$	66 days



Comment:-

From the above figure we can see that inventory holding period shows an increasing trend from 2005 to 2006 i.e from 66 days to 105 days. It shows that Indian Tool Manufacturers Ltd. was holding inventory for more than 3 & ½ months. It has improved a lot in 2008 it come down to almost 66 days from 105 days as compared to previous years.

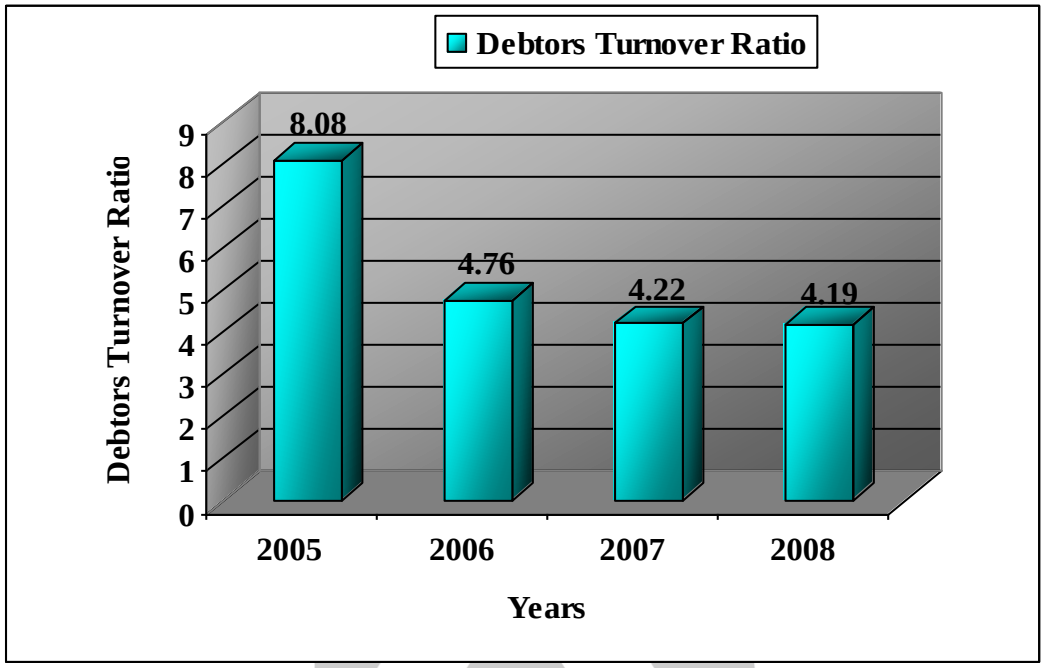
4. DEBTORS TURNOVER RATIO

It is determined by dividing net credit sales by average debtors outstanding during the year. The analysis of debtors turnover ratio supplements the information regarding the liquidity of one item of current assets of the firm. The ratio measures how rapidly debts are collected. A high ratio is indicative of shorter time-lag between credit sales and cash collection. The low ratio shows that debts are not being collected rapidly.

Debtors Turnover Ratio = Net Credit Sales / Average Debtors

Average Debtors = Opening + Closing / 2

Year	Net Credit Sales / Average Debtors	Debtors Turnover Ratio
2005	571,118,380 / 70,665,180	8.08
2006	482,553,300 / 101,301,080	4.76
2007	570,499,580 / 135,318,475	4.22
2008	688,510,180 / 164,265,710	4.19



Comment:-

Debtors Turnover Ratio measures how rapidly the debts are collected. Higher ratio is indicative of shorter time lag between credit sales and cash collection. A low ratio shows that debts are not rapidly collected.

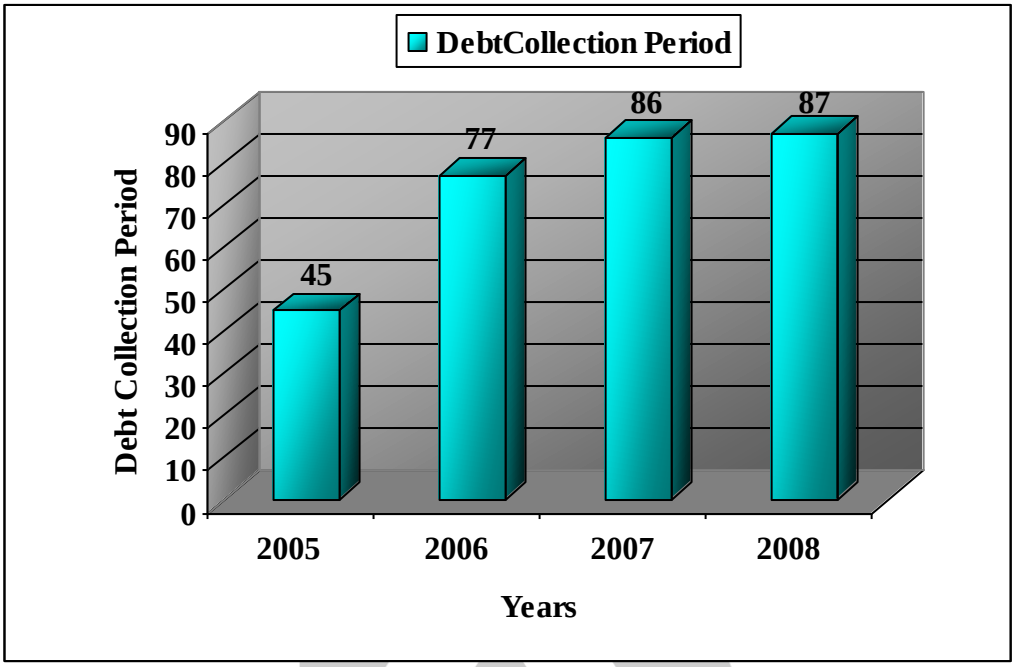
Indian Tool Manufacturers Ltd. has a turnover ratio of 8.08 which signifies that debtors got converted into cash 8 times in a year2005. From year 2006 onwards it is seen that debtors turnover ratio is decreasing slowly, it signifies that debtors are getting converted to cash 4 times in a year. The company should improve its debtors turnover ratio.

5. DEBT COLLECTION PERIOD

This ratio measures how long it takes to collect amounts from debtors. The ratio represents the average number of days, for which a firm has to wait before their receivables are converted into cash.

$$\text{Debt Collection Period} = \frac{365}{\text{Debtors Turnover Period}}$$

Year	$\frac{365}{DTR}$	Debt Collection Period
2005	$\frac{365}{8.08}$	45 days
2006	$\frac{365}{4.76}$	77 days
2007	$\frac{365}{4.22}$	86 days
2008	$\frac{365}{4.19}$	87 days



Comment:-

The higher the ratio, lower is the collection period while lower ratio indicates high collection period.

In year 2005, Indian Tool manufacturers Ltd. has higher turnover ratio and shorter collection period, so there was better trade credit management and the better liquidity of debtors, as short collection period and high turnover ratio imply prompt payments on the part of debtors. On the other hand from 2006 onwards the Co. has lower turnover ratio and higher collection period which indicates delayed payments by debtors. In general, Co. should prefer short collection period.

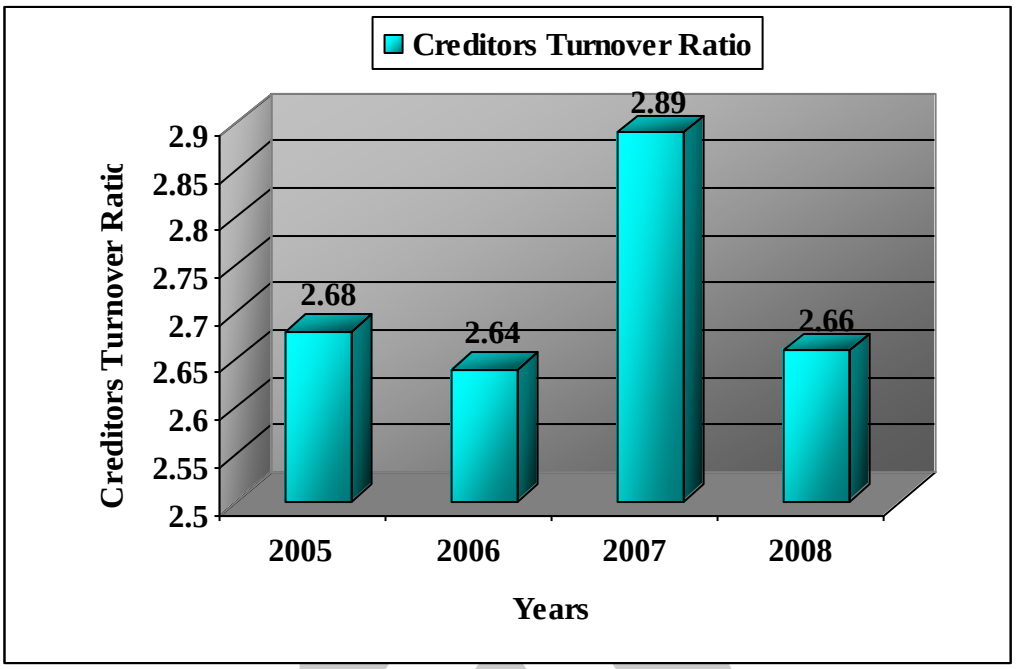
6. CREDITORS TURNOVER RATIO

It is a ratio between net credit purchases and the average amount of creditors outstanding during the year. A low turnover ratio reflects liberal credit terms granted by suppliers, while a high ratio shows that accounts are to be settled rapidly. The creditors turnover ratio is an important tool of analysis as a firm can reduce its requirement of current assets by relying on suppliers credit. The extent to which trade creditors are willing to wait for payment can be approximated by the creditors turnover ratio.

$$\textbf{Creditors Turnover Ratio} = \frac{\textbf{Credit Purchases}}{\textbf{Average Creditors}}$$

Average Creditors = Opening + Closing / 2

Year	Credit Purchase / Average Creditors	Creditors Turnover Ratio
2005	159,501,090 / 59,495,750	2.68
2006	166,010,140 / 62,794,710	2.64
2007	184,698,590 / 63,854,810	2.89
2008	273,751,350 / 103,040,660	2.66



Comment:-

A low turnover ratio reflects liberal credit terms granted by suppliers, while a high ratio shows that accounts are to be settled rapidly. The credit turnover ratio is an important tool of analysis as a firm can reduce its requirement of current assets by relying on suppliers credit.

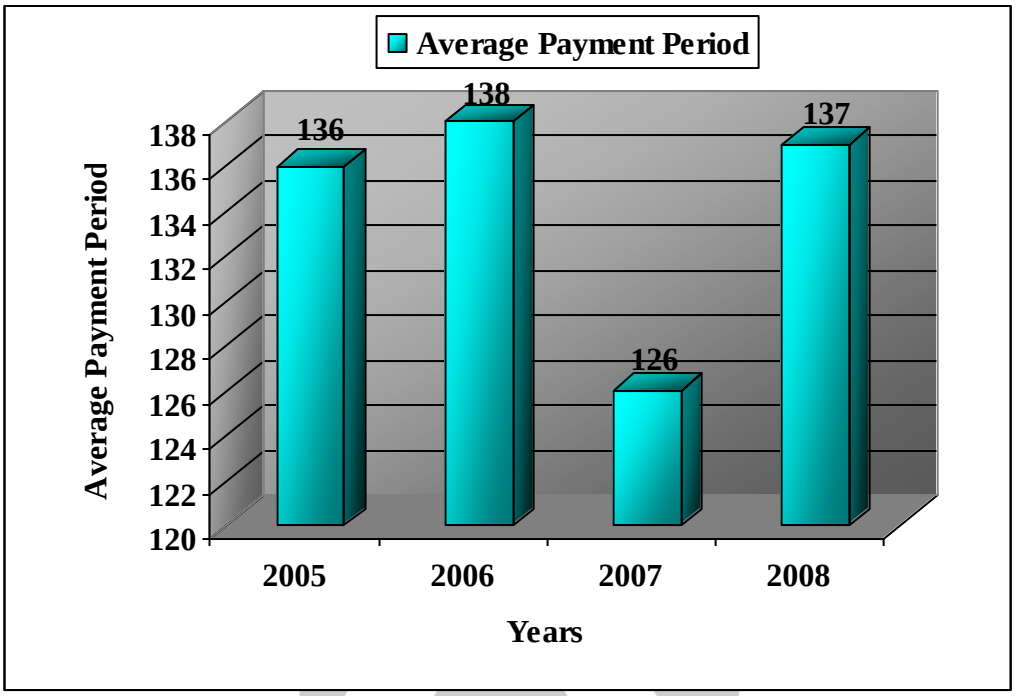
Indian Tool Manufacturers Ltd. has high ratio in the year 2007 as seen in the above graph, which indicates that the account of creditors is settled rapidly. In rest of the years there is decrease in the ratio, which shows that liberal credit terms are granted by suppliers.

7. AVERAGE PAYMENT PERIOD

The measurement of the creditors payment period shows that average time taken to pay for goods and services purchased by the company. In general, the longer the credit period achieved, the better, because delays in payment mean that the operations of the company are being financed interest free by suppliers funds.

$$\textbf{Average Payment Period} = \frac{365}{\text{Creditors Turnover Ratio}}$$

Year	$\frac{365}{CTR}$	Average Payment Period
2005	$\frac{365}{2.68}$	136 days
2006	$\frac{365}{2.64}$	138 days
2007	$\frac{365}{2.89}$	126 days
2008	$\frac{365}{2.66}$	137 days



Comment:-

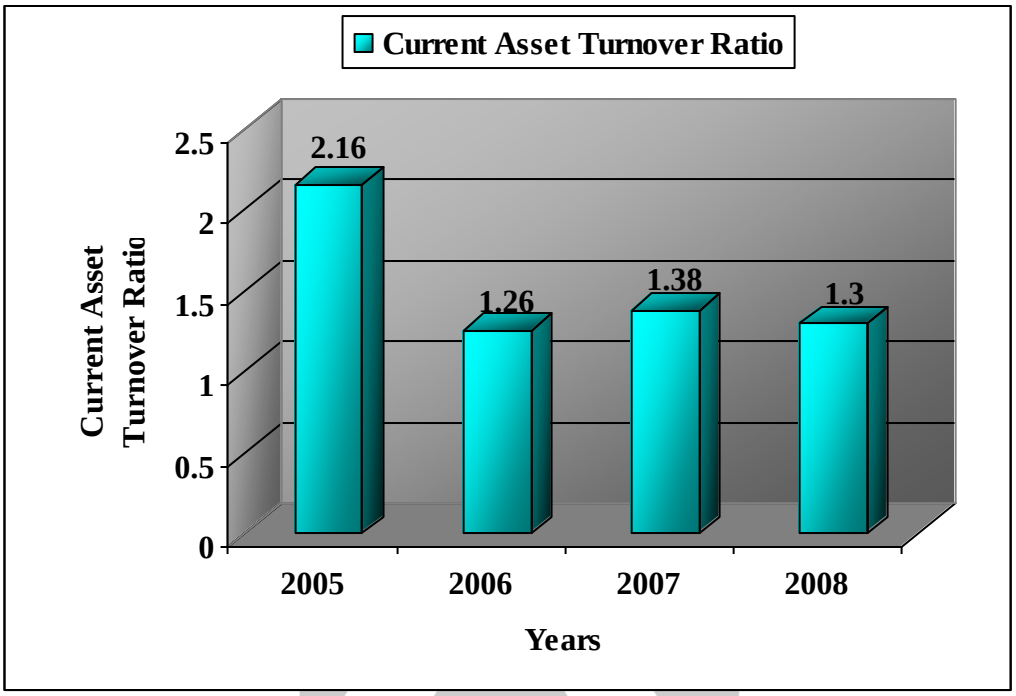
The creditors payment period is high it should be decreased, but it is seen from the above graph that earlier in 2006 there was an increase in creditors payment period compared to rest of years. But Indian Tool Manufacturers Ltd. has reduced the creditors payment period in the year 2007. In rest of the years the Co. got liberal credit terms from its supplier.

8. CURRENT ASSET TURNOVER RATIO

This ratio indicates the efficiency with which current assets turn into sales. A higher ratio implies by and large a more efficient use of funds. Thus, a high turnover rate indicates reduced lock-up of funds in current assets. An analysis of this ratio over a period of time reflects working capital management of a firm.

Current Asset Turnover Ratio = Sales / Current Assets

Year	Sales / Current Assets	Current Asset Turnover Ratio
2005	571,118,380 / 263,811,830	2.16
2006	482,553,300 / 381,787,420	1.26
2007	570,499,580 / 412,558,980	1.38
2008	688,510,180 / 530,407,680	1.30



Comment:-

The current assets turnover ratio indicates the firms efficiency in utilization of its assets. The greater ratio the more efficient the management is and utilization of assets is and lower ratio indicates under utilization of assets.

Indian Tool Manufacturers should increase its current assets turnover ratio which is seen to be decreasing. The firm should carefully utilize its assets in order to increase the efficiency of the firm.

CONCLUSION OF THE STUDY

Since this project was conducted to analyze the working capital of Indian Tool Manufacturers Ltd. for the last four years from 2005 to 2008. During this project work and project report I came to some conclusions which are as follows:

- The Net Working Capital of the firm is showing an increase in each year, which indicates that Indian Tool Manufacturers has a sufficient Net Working Capital to meet the claims of creditors and day to day needs of business.
- Indian Tool Manufacturers has improved its current ratio, which is more than 2:1. Hence, it is able to meet its obligations and for the creditors the firm is less risky. On the other hand quick ratio shows that the firm has sound financial position.
- The firm had higher working capital turnover ratio i.e.3.86 in the year 2005 which shows better utilization of the working capital as well as lower inventory in working capital. After 2005 it is seen that it is declined and again from 2007 it is increasing slightly for which the firm should give proper attention towards utilization of working capital.
- Debtors turnover ratio is declining every year which signifies that the debts are not getting converted into cash rapidly. They should reduce their collection period which is normally 60 days as per credit terms fixed by the company.
- Liberal credit terms are granted by the suppliers of the company and the company should try to reduce their payment period.
- The current assets turnover ratio indicates the firms efficiency in utilization of its assets. The firm should carefully utilize its assets in order to increase the efficiency of the firm which is seen declining every year.

RECOMMENDATIONS AND SUGGESTIONS OF THE STUDY

Following are the recommendations and suggestions for the company.

- The company should maintain its inventory at a certain level otherwise it would incur unnecessary block up of the funds which will result in heavy increase in working capital.
- After the analysis it is seen that debtors are not getting converted into cash even after granting credit period of 60 days. The company should strictly monitor its debtors and vigorous follow up should be made for the timely realization of its overdue debtors.
- The payment to creditors should be made within the time limit to avoid excess liabilities which would harm the credit worthiness of the company and to get liberal credit terms from its suppliers.
- The company should increase its market share by offering competitive prices in local as well as global markets.
- The company should implement the cost saving measures very effectively at all the stages of its operations i.e. for raw material procurements, production process, material handling process, administrative cost and better management of financial resources.

BIBLIOGRAPHY

Before and at the time of preparing the project report following books were referred which supported me with some important guidelines for the analysis and the documentation of project report.

The books used for this purpose are –

1. **Financial Management – Khan & Jain**
2. **Financial Management – Prasanna Chandra**
3. **Cost Accounting & Financial Management – SamirKumar Chakravarthy**
4. **www.indiantool.com**