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"A Study Of Financial Management System Adopted At Indoworth Indai Pvt. Ltd. Butibori, Nagpur."

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Abstract: *"Financial management may be defined as that area or set of administrative function in an organization which relate with arrangement of cash and credit so that organization may have the means to carry out its objective as satisfactorily as possible Financial Management is the Operational Activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operation The significance of this function is not only seen in the 'Line' but also in the capacity of 'Staff' in overall administration of a company. It has been defined differently by different experts in the field. It includes how to raise the capital, how to allocate it i.e. capital budgeting. Not only about long term budgeting but also how to allocate the short term resources like current assets. It also deals with the dividend policies of the share holders." by Joseph Massie "Business finance deals primarily with rising administering and disbursing funds by privately owned business units operating in non-financial fields of industry." – By Kuldeep Roy "Financial Management is an area of financial decision making, harmonizing individual motives and enterprise goals." By Weston and Brigham "Financial management is the area of business management devoted to a judicious use of capital and a careful selection of sources of capital in order to enable a business firm to move in the direction of reaching its goals." – by J.F.Bradlery "Financial management is the application of the planning and control function to the finance function." – by K.D. Willson.*

Keywords: *Financial management, capital budgeting, profit maximization and value addition.*

I. Introduction

Working capital management is the way a company manages the relationship between assets and liabilities in the short term. Simply put, working capital management is how a company manages its money for day to day operations as well as any immediate debt obligations. When managing working capital, the company has to manage accounts receivable, accounts payable, inventory, and cash. The goal of working capital management is to have adequate cash flow or continued operations and have the most productive usage of resources.

There are a few calculations we have to discuss to in regards to working capital management. To calculate working capital, a company would take current assets and subtract current liabilities.

Working capital efficiency is determined by calculating the working capital ratio. This ratio is a key indicator in the company's financial health. The working capital efficiency is calculated by taking current assets divided by current liabilities. If the result of the calculation is less than 1.0, then it is taken as a sign that the company is having financial issues. If the result of the calculation is greater than 1.0 but less than 2.0, then the company is in good financial health. If the calculation yields a result greater than 2.0, then company may not be making an effective use of its assets.

The next calculation we need to understand is receivables turnover. This is a calculation of how many times an n account is created and collected during the reporting period. Receivables turnover is calculated by dividing the total revenue by average receivables. That was a long way to say how many times orders are being created and invoiced during the reporting period.

The last calculation we need to understand for working capital management is the inventory turnover ratio. The inventory turnover ratio is calculated by costs of goods sold divided by the average inventory costs. If the results are less than 1.0 then the company is not moving enough inventory.

Management of working capital

Guided by the above criteria, management will use a combination of policies and techniques for the management of working capital. The policies aim at managing the current assets (generally cash and cash equivalents, inventories and debtors) and the short-term financing, such that cash flows and returns are acceptable.

Cash management. Identify the cash balance which allows for the business to meet day to day expenses, but reduces cash holding costs.

Inventory management. Identify the level of inventory which allows for uninterrupted production but reduces the investment in raw materials—and minimizes reordering costs—and hence increases cash flow. Besides this, the lead times in production should be lowered to reduce Work in Process (WIP) and similarly, the Finished Goods should be kept on as low level as possible to avoid over production—see Supply chain management; Just In Time (JIT); Economic order quantity (EOQ); Economic quantity

Debtors management. Identify the appropriate credit policy, i.e. credit terms which will attract customers, such that any impact on cash flows and the cash conversion cycle will be offset by increased revenue and hence Return on Capital (or vice versa); see Discounts and allowances.

Short-term financing. Identify the appropriate source of financing, given the cash conversion cycle: the inventory is ideally financed by credit granted by the supplier; however, it may be necessary to utilize a bank loan (or overdraft), or to "convert debtors to cash" through "factoring".

Importance of Working Capital Management:

Efficiently maintaining a balanced ratio between current assets and current liabilities is called working capital management. Working capital management ensures that that the company has enough monetary liquidity to meet short term debts. Structuring an effective working capital management is a great way to enhance the income. Ratio analysis and management of individual components of working capital are two primary importance of working capital management. Ratio analysis: Process of determining and analyzing numerical relationships in accordance to financial statements like balance sheets, income statements and cash inflow statements is known as ratio analysis. The primary purpose of ratio analysis is to appraise the operating and financial performance of an economic activity and determine its efficiency, profitability, liquidity and solvency. It also helps in getting a brief idea about comparative valuation by comparing ratios of different companies in the same sector. Inventory Management: Inventory management involves overseeing the purchase of new items and managing the existing ones. It aims to create such a purchase plan that will ensure effective delivery of materials. Two most used inventory management strategies are 'the just-in-time method' and 'material required planning.' In former one the firm plans to receive items at the time of need rather than maintaining high inventory levels, and the latter one is based sales forecasts. Cash Management: Cash management is process of collecting, managing and utilizing the cash inflow to optimize the short term financial stability. The key component in accomplishing this task is solvency. Successful cash management is useful when any unexpected demand for cash occurs out of the blue. Objectives of Working Capital Management: Few of the importance objectives of working capital management are listed below:

1. **Optimization of working capital operating cycle** – In simple terms, working capital cycle starts from the day raw materials are acquired and completes when the finished products are sold. The major objective of working capital management is to ensure that there is no hindrance during the above mentioned process. It includes collecting and processing raw materials and other initial investment in time, placing all the essentials for production beforehand, selling finished products as soon as possible, collecting account receivables on time and clearing all the account payable's in time.

2. **Balance Working Capital** – The net working capital mentioned above is required to stay in a stable equilibrium. The ratio of current assets and current liabilities should be optimized. Because the lower value of this ratio implies that company is not financially stable to clear its current debts, higher value is also not an indication of prosperity, it suggests that company has too many inventories and they are not investing in excess cash.

3. **Minimize cost of capital** – Working capital management focuses on minimizing cost of capital, rate of interest per say in some special cases. It is only when the cost of capital will be lesser than revenue, one can earn profit. Utilization of long-term funds (in proper mix) is one way of minimizing capital cost. The fundamental principle of financial management should be followed sincerely while deciding the finance mix, always. The principle states that long term sources should finance fixed assets and permanent assets. Also, the short-term or temporary assets should be financed by short-term sources of finance.

4. **Optimal Return on Current Asset Investment** – The return on the investment infused on short term assets must exceed the average cost of capital to ensure wealth maximization. In other words, the rate of return earned

from the investment in short term assets should exceed the rate of interest or cost of capital. Working capital management aims to extract maximum from an investment in current assets to ensure higher profitability. Conclusion: So by now you know that working capital management is a managerial accounting strategy that aims to optimize higher ROI (return on investment) and minimize cost of capital. During any financial crisis, the accounting team focuses on enhancing the company’s working capital management to normalize day to day business activity

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Useful for Company

Working capital management is really cash flow management. Anyone in your business who deals with the components of working capital should be in the loop about the consequences of locking up too much cash. For example, workers who see unsold items stacking up or who have to turn away customers seeking sold-out items should recognize these as threats to the company's well-being. Employees handling outgoing bills should know which ones must be paid now and which ones can wait for two weeks.

II. Literature Review

The relationship between working capital management and firms’ profitability does attract many scholars’ attentions. The relationship has been investigated on a sample that covers different industries and periods, giving a clear and reliable result. Besides Shin, and Soenen (1998), Deloof (2003), Gill, Biger, and Mathur (2010) test this relationship on the sample of firms listed on the New your stock exchange. And Falope and Ajilore (2009) examined this relationship on non-financial firms for the period 1996-2005. Both results show a significant negative relationship between cash conversion cycle and firm’s profitability. The suggestions they gave are in line with the suggestion given by Shin and Soenne (1998) and Deloof (2003): managers can create value for firm by minimizing the number of cash conversion cycle into a reasonable level. Furthermore, no significant difference in the effect of working capital management on the firm’s size is found in the study of Falope and Ajilore (2009).

How working capital management affects firms’ performance on small manufacturing firms is examined by Padachi (2006). Return on asset is used to measure firms’ profitability (performance) in the paper. The paper gives the relationship between working capital management and firms’ profitability a further look. It can be distinguished from other papers because this study gives a detailed test on how each component of working capital management impacts on firms’ performance. This can give manager more insight when making

decision on working capital. The results show that higher investment in inventories and receivables, the lower the profitability is. And that cash conversion cycle is negatively reacted to the firms' profitability.
Eljelly (2004) tests the relationship between firm profitability and liquidity since working capital can be considered as an indication of firms' liquidity. Eljelly (2004) studies a sample of 929 Joint stock companies in Saudi Arabia. The big difference in his paper from the previous paper is that Eljelly uses two measures, current ratio and cash conversion cycle, for liquidity. There are two significant study results are found: firstly, firm's profitability has a negative relationship with its liquidity level, which is measured by current ratio. Second, cash conversion cycle is more important than current ratio that affects profitability as a measure of liquidity. Two study results stay stable over time in the study sample.

III. Hypothesis

In the literature review, we can see that most studies have been done are about how working capital management impact on firm's profitability. All the outcomes reach a similar conclusion that: with an efficient working capital management, which is shorter cash conversion cycle, firm's profitability is higher. Autukaite and Molay (2011) and Kieschnick, Laplante, and Moussawi (2011) both study the relationship between working capital and firm's value (performance), a similar conclusion is draw from both studies that: one Euro invested in the working capital management will generate less than one Euro for the firm. . In the research of Luo, Lee and Hwang (2009), they examine how efficiency of working capital affects firm's further performance and firm's value.

Hypothesis I: There is a possible negative relationship between firm's Days sales Outstanding (DSO) and firm value. Firms with shorter Days Sales Outstanding are expected to have a higher firm value. Second, how quick management can turn inventories into cash is described by Days Inventory Outstanding. Usually, a lower Days inventory Outstanding indicates a better performance in Inventory management since company can sell inventory fast and get rid of costs and risks. If a company takes longer time to sell its inventories, firm needs to afford carrying costs and the risk that inventory will be decadent or out of date.

Hypothesis II: There is a negative relationship exists between firm's Days Inventory Outstanding (DIO) and firm value. If a firm uses less time to convert their inventories to sales, firm value is expected to be higher. Third, as an important element of working capital, account payable catches well attention from managers. Days Payable Outstanding measures how many days it takes for a firm to pay their credit. The benefit of stretching Days payable Outstanding is that it can save some working capital investment for companies. On the other side, taking a long time for a company to pay for their vendors runs the risk of having a bad business relationship with suppliers.

Hypothesis III: A positive relationship may exist between firm value and Days Payable Outstanding (DPO). Therefore, if Days Payable Outstanding (DPO) is longer, firm value is larger. Last, based on the theory background and previous literature result, a negative relationship between firm value and cash conversion cycle is expected. Cash conversion cycle measure the length of time a firm uses between actual cash expenditure on material resource and cash Limin Lai s237020 Supervisor: Drs. J. Grazell Master Thesis: The Impact of Working Capital Management on Firm Value: Evidence from Airline Industry revenue from products (Eljelly, 2004). A shorter cash conversion cycles illustrates that firm has an efficient working capital management, which also indicates a better liquidity. With an efficient working capital management, firm can have sufficient cash to run their daily business and future growth investment. The risk of financial constraints can be reduced. Consequently, firm value can increase.

Hypothesis IV: There is a possible negative relationship between firm value and working capital management (cash conversion cycle). When working capital is efficient, which is indicated by shorter cash conversion cycle, firm value can be higher.

IV. Conclusion

A Large numbers of research and examples show that working capital management is an important part of financial management of a firm. Working capital management can therefore be expected to be as efficient as possible. Most literature proves there is a negative relationship between working capital management and firm profitability. Luo, Lee and Hwang (2009) illustrate that efficiency working capital management has lasting effect on firm performance and with efficient working capital management, cash conversion cycles is shorter, firm value is higher.

The aim of this investigation is to test whether firm value can negatively relate to cash conversion cycle in the sample of airline industry study, and how working capital management affects firm value. With this in mind, I used a sample of 296 firm years from airline industry, covering the period 2003-2011. The findings of this paper are in line with findings of Luo, Lee and Hwang (2009). Days Inventory Outstanding is negatively and significantly related to firm value, it suggests that managers can create firm value by reducing DIO. Although Days Sale Outstand and Days Payable Outstanding is not significant in the empirical tests, but theoretically speaking, minimize Day Sales Outstanding (DSO) and stretching Days Payable Outstanding (DPO) can have positive effect on firm value. The negative relationship between firm value and cash conversion cycle, which is approved in the paper, suggests manager should try to minimize cash conversion cycle to create firm value. This negatively relationship can be explained by that: working capital management is directly and closely related to firms' liquidity. Liquidity will be improved if efficient working capital management (shorter cash conversion cycle) is applied in firms. Finally, firm value can be increased due to better liquidity. The explanation also confirmed by the investigation of Bandara and Weerakoon-Banda (2011) that working capital management affects firm's profitability and liquidity before affecting firm value.

These findings are important because they show the relationship between working capital management and firm value, and the way how it affects firm value. They give managers some insights that firm value can be created by reducing the cash conversion cycle to improve the liquidity. In order to do this, reducing Days Sales Outstanding (DSO) and Day Inventory Outstanding (DIO) or increasing Day Payable Outstanding (DPO) is necessary. Findings also

give investors some insights when they evaluate firms' financial health and make their correct investment decision. Students can understand how working capital works and the importance of working capital management to firm value.

Limitation

The limitations of this study are the sample is only from airline industry firms. The finding of this study can only apply to the airline industry. Since the sample comes from airline industry and the study consider the feature of airline industry that deferred revenue is an important element of working capital. The application of the result from airline industry can be limited to other industry. Secondly, the size of sample is rather small. The accuracy of result can be affected. Due to the limitation of database, there are only 296 observation are available, this can be the drawback of study. Thirdly, there may some outliner exist in the sample, which may cause skewness in the result.

Future research

Future research can enlarge the sample of airline industry or the sample beyond the airline industry. The scope of future investigation can be extended to focus on the detail of relationship between each component of working capital management and firm value or other performance. Especially focus on Days Sales Outstanding and Days Payable Outstanding since they are not significant in this airline industry study. More proxies of firm value and working capital management can be applied into the research in order to make sure findings are more accurate.

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