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Working Capital Management Analysis: an Empirical study of leading Hotels in India

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Abstract

For smooth functioning of an enterprise, sufficient amount of working capital is very essential. Efficiency in this area can help, to utilize fixed assets gainfully, to assure the firm's long- term success and to achieve the overall goal of maximization of the shareholders, fund. Shortage or bad management of cash may result in loss of cash discount and loss of reputation due to non-payment of obligation on due dates. Insufficient inventories may be the main cause of production held up and it may induce the enterprises to purchase raw materials at unfavorable rates. Like-wise facility of credit sale is also very essential for sales promotions. The present study mainly analyses how far Indian hotels have utilized the working capital to maintain the liquidity and profitability of companies. The study concludes that selected hotels should review their working capital management policies and make more efforts to improve liquidity position and profitability. The major issues are low inventory turnover, high average collection period etc. Selected hotel should improve the quantity of sales by creating more demand and improving occupancy rate of hotel rooms. There is need of standard collection policy for quick collection of debt.

Key words: Management of Working Capital, Working Capital Management, Financial Performance, Ratio Analysis, Hotels

Introduction:

Every business needs investment to procure fixed assets, which remain in use for a longer period. Money invested in these assets is called 'Long term Funds' or 'Fixed Capital'. Business also needs funds for short-term purposes to finance current operations. Investment in short term assets like cash, inventories, debtors etc., is called 'Short-term Funds' or 'Working Capital'. Working capital refers to that part of the firm's capital which is required for financing short term or current assets such as cash, marketable securities, debtors and inventories. Funds, thus, invested in current assets keep revolving fast and are being constantly converted into cash and this cash flow out in exchange for other current assets. Hence it is also known as circulating capital or revolving capital or short term capital.

The 'Working Capital' can be categorized, as funds needed for carrying out day-to-day operations of the business smoothly. The management of the working capital is equally important as the management of long-term financial investment.

According to Genestenberg:- "Circulating capital means current assets of a company that are changed in the ordinary course of business from one form to another, as for example, from cash to inventories, inventories to receivables into cash."

The working capital is needed for the following purposes:-

a) For the purchase of raw materials, components and spares.

b) To pay wages and salaries.

c) To incur day-to-day expenses and overhead costs such as fuel, power and office expenses etc.

d) To met the selling costs as packing, advertising etc.

e) To provide credit facility to customers.

f) To maintain the inventories of raw material, work-in-progress, stores and spares and finished stock.

Every running business needs working capital. Working capital management is concerned with efficient management of current assets and current liabilities. It deals with the adequacy of current assets and risk posed by current liabilities.

Therefore the financial manager has to take proper decision from time to time keeping in view the objective of his company. The decision must be based on the analytical tools. Financial analysis is the most useful techniques in this regard.

About the Tourism and Hotel Industry:

Tourism has now become a significant industry in India. The Indian tourism industry has been flourishing in recent years due to the improved connectivity to and from the country. As per the World Travel and Tourism Council, the tourism industry in India is likely to generate US $121.4 bn of economic activity by 2015, and the hospitality sector has the potential to earn US $24 bn in foreign exchange by 2015. The booming tourism industry has had a cascading effect on the hospitality sector with an increase in the occupancy ratios and average room rates. In FY14, the occupancy ratio was around 57%, up 1% from last year. The average room rate decreased over the last one year by about 3.4% due to supply pressures and the general slowdown in the economy. (**India Brand Equity Foundation)**

Hotels are one of the most important institutions in the field of tourism industry. Hotel industry is flourishing at a very fast rate. Undoubtedly the high quality food and beverage, reception, housekeeping and full state of the art technology have played a momentous role in the expansion of hotel industry in India. The main objective of this study is to examine the liquidity position and working capital management of selected hotels India.

Objectives of the Study

1. To analyze the Working Capital Position of selected hotels in India
2. To examine the liquidity position of selected hotels.

Methodology:

The scope of the study is limited to 5 leading hotels which are listed in BSE stock exchange. The selected hotels are The Indian Hotels Company Limited (IHCL), East India Hotels Ltd (EIHL), Asian Hotels (North) (AH(N)), Hotel Leela Venture (HLV), Indian Tourism Development Corporation (ITDC). The whole study is based on secondary data and financial results of the selected hotels. The study covers a period of 10 years from 2004-05 to 2013-14. Analysis has been made by covering the collected data into relative measures such as ratios, averages, percentages.

For the purpose of analysis of data various ratios relating to working capital management is calculated, moreover, the simple technique such as standard deviations, average, and co efficient of variation also applied to analyze the consistency. In present study data has been converted into relative measures such as ratios, percentage rather than the absolute data.

Analysis of Working Capital Position

The following ratios are used to analysis the cash position.

- **Current Ratio**
- **Liquid / Quick Ratio**
- **Inventory turnover ratio**
- **Debtors turnover ratio**
- **Average collection period**
- **Working capital turnover ratio**
- **Cash turnover ratio**

Current Ratio

This ratio is an indication of the firm's commitment to meet its short term commitment to meet its short term liabilities; the ratio of 2:1 is considered quite standard because higher ratio affects the profitability of a concern adversely. But for hotel industry a ratio of 1.5:1 may be considered satisfactory as there is low level of stock and high synchronization in comparison to manufacturing companies.

$$\text{Current Ratio} = \frac{\text{Currents Assets}}{\text{Current Liabilities}}$$

Table 1. Current ratio

Year	IHCL	EIHL	AH(N)	HLV	ITDC	Industry
2004-05	2.21	1.26	0.58	3.90	1.76	1.94
2005-06	2.37	1.12	0.56	1.95	1.95	1.59
2006-07	1.29	0.66	0.54	0.94	1.72	1.03
2007-08	1.33	0.37	1.15	1.70	2.36	1.38
2008-09	2.28	0.47	1.04	0.79	2.82	1.48
2009-10	1.73	0.34	0.48	0.83	1.59	0.99
2010-11	1.33	0.37	0.14	0.94	1.65	0.89
2011-12	0.86	0.27	0.32	0.35	1.73	0.71
2012-13	1.09	1.15	0.24	0.18	1.81	0.89
2013-14	0.97	0.57	0.25	0.15	1.80	0.75
MEAN	1.55	0.66	0.53	1.17	1.92	1.17
S.D.	0.56	0.38	0.33	1.13	0.38	0.41
C.V	36.47	57.28	63.18	96.01	19.93	35.20

Above table shows the current ratio of the selected hotels during the period of study. From table it is clear that IHCL, Hotel Leela venture Ltd and ITDC are playing quite safe and having sufficient current assets against current liabilities. The study reveals that the current ratio of the Indian Hotels Company Limited showed descending and fluctuating trend during the study period. The average ratio was 1.55. The ratio of East Indian Hotels Limited is fluctuating trend throughout the study period. ITDC has on an average 1.92 times current assets to current liability and consistently maintaining the high level of current assets as indicated by its C.V. The ratio of the Hotel Leela Venture Limited is an average of 1.17. The ratio showed highly fluctuated trend during the study period. The industry average is 1.17 which is not up to the standard because the selected companies have not maintained the standard of 2:1. EIHL and Asian Hotels should improve its liquidity position by increasing the level of current assets and reducing the level of current liability.

Liquid or Quick Ratio

Liquid ratio as quick ratio, it is more rigorous test of liquidity than current ratio, two department of current ratio, as a measure of liquidity, are current assets and current liabilities. Standard ratio for liquid ratio is 1:1.

$$\text{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Current Liabilities}}$$

Quick ratio of selected hotels are shown in table 2.

Table 2: Quick ratio

Year	IHCL	EIHL	AH(N)	HLV	ITDC	Industry
2004-05	2.32	0.48	0.46	10.42	1.55	3.05
2005-06	2.39	0.44	0.46	1.92	1.71	1.38
2006-07	1.43	0.65	0.71	0.80	1.65	1.05
2007-08	1.81	0.61	1.47	1.82	2.32	1.61
2008-09	2.40	0.53	1.05	0.80	2.77	1.51
2009-10	1.57	0.59	0.42	0.84	1.44	0.97
2010-11	1.19	0.62	0.48	1.12	1.50	0.98
2011-12	0.81	0.85	0.38	0.35	1.60	0.80
2012-13	1.20	1.03	0.27	0.20	1.68	0.88
2013-14	1.04	0.91	0.42	0.18	1.66	0.84
MEAN	1.62	0.67	0.61	1.85	1.79	1.31
S.D	0.59	0.19	0.37	3.07	0.42	0.68
C.V	36.43	29.01	60.79	166.55	23.53	51.72

Table 2 reveals that all hotels except EIH and Assian hotels have not maintained satisfactory level of liquid assets on higher side. EIH and Asian hotels should improve the liquidity position by increasing the level of liquid assets and reducing current liabilities. Almost all the selected hotels have attained the standard position to ensure a trade-off between risk, liquidity and profitability.

The quick ratio of Indian Hotels Company Limited was fluctuating trend during the study period. The ratio showed that during the whole study period company could not maintain the quick ratio according to the standard norms. During the period of study, the ratio is higher than standard ratio i.e.1:1. It indicates that the Indian Hotels Company Limited is keeping the quick assets in an idle position.

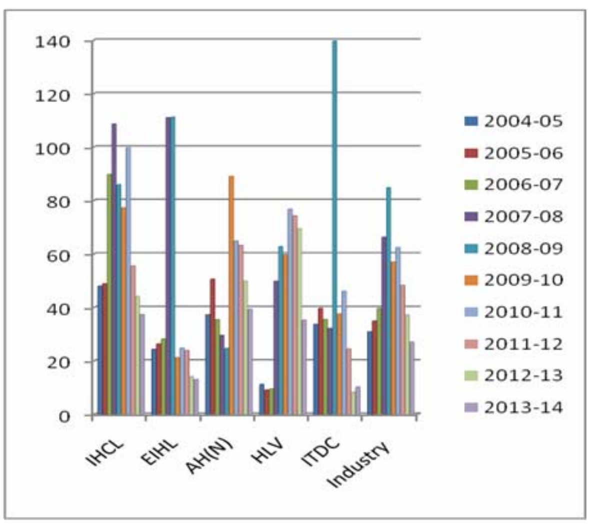
Inventory Turnover Ratio:

A firm has to always maintain an optimum level of inventory to meet the requirement of the business. But the level of inventory should neither be too high nor too low. Therefore inventory turnover ratio is calculated to know how quickly the inventory is being utilized by the selected hotels companies.

It is calculated by dividing the cost of goods sold by the average inventory thus:

$$\text{Inventory turnover ratio} = \frac{\text{Cost of goods sold}}{\text{Average Inventory}}$$

Figure:1: Inventory turnover ratio



The figure reveals that all selected hotels other than EIH are performing better over the period of study. Average of ITR of EIH is less than the industry average ITR. Even EIH has average ITR i.e. 39.85 times less than industry average, so required much attention of management to monitor the inventory level and improve the same significantly.

Debtors turnover ratio :

Debtors constitute an important constituent of current asset and therefore the quality of debtors to a great extent determines a firm's liquidity. This ratio shows the relationship between net sales and debtors of a concern. This ratio helps to judge the adequacy of working capital. Debtors are expected to be converted in to cash over a short period and therefore are included in current assets. It is expressed as follows:

$$\text{Debtors turnover ratio} = \frac{\text{Total Sales}}{\text{Sundry Debtors}}$$

It is also determined by dividing the net credit sales by average debtors outstanding during the year. Thus,

$$\text{Debtors turnover ratio} = \frac{\text{Net Credit Sales}}{\text{Average Debtors}}$$

Table 4: Debtors Turnover Ratio

Year	IHCL	EIHL	AH(N)	HLV	ITDC	Industry
2004-05	15.46	11.86	21.54	11.02	4.97	12.97
2005-06	15.00	13.05	24.61	11.61	3.97	13.65
2006-07	15.81	13.08	23.83	11.08	4.02	13.56
2007-08	14.84	14.13	24.99	12.07	4.59	14.12
2008-09	13.19	16.25	9.70	12.40	3.64	11.04
2009-10	13.49	12.75	35.24	12.90	4.55	15.79
2010-11	13.29	10.85	34.80	12.55	3.54	15.01
2011-12	14.94	14.24	36.04	11.58	4.27	16.21
2012-13	14.40	10.37	40.50	10.27	8.51	16.81
2013-14	12.22	8.99	39.37	12.99	8.55	16.42
MEAN	14.26	12.56	29.06	11.85	5.06	14.56
S.D	1.16	2.12	9.73	0.89	1.88	1.82
C.V	8.11	16.87	33.48	7.52	37.14	12.53

Table 4 shows that, average DTR of ITDC is very less compared other hotels towards industry average. Average DTR of IHCL, EIH and Hotel Leela venture slightly less than average DTR of industry. All hotels need to improve the credit policy to speed up the recovery of debt from debtors.

Average collection period:

This ratio gives an indication of the efficiency of the credit and collection policy of the firm and it will directly affect the cash position of the company, it is a test of speed in which debtors are converted in to cash, thus debtor ratio is an important tool of analyzing the efficiency of cash management of a company.

$$\text{Debtor Ratio} = \frac{\text{Debtors} \times 365 \text{ days}}{\text{Net Sales}}$$

The average collection period of selected hotels are shown in table

Table 5: Average collection period

Year	IHCL	EIHCL	AH(N)	HLV	ITDC	Industry
2004-05	24	31	17	33	73	36
2005-06	24	28	15	31	92	38
2006-07	23	28	15	33	91	38
2007-08	25	26	15	30	80	35
2008-09	28	22	38	29	100	43
2009-10	27	29	10	28	80	35
2010-11	27	34	10	29	103	41
2011-12	24	26	10	32	86	35
2012-13	25	35	9	36	43	30
2013-14	30	41	9	28	43	30
MEAN	26	30	15	31	79	36
S.D	2.17	5.34	8.5	2.4	21.19	4.29
C.V	8.41	17.88	57.21	7.74	26.81	11.88

Table 5 reveals that Asian hotel has performed better continuously compared to the other selected hotels. ITDC average collection period is very high and should improve its credit policy. ACP of IHCL, EIHCL and Leela venture hotels are less than the ACP of industry. Though they are performing better than ITDC, they should make more efforts to do speedy collection of debtors.

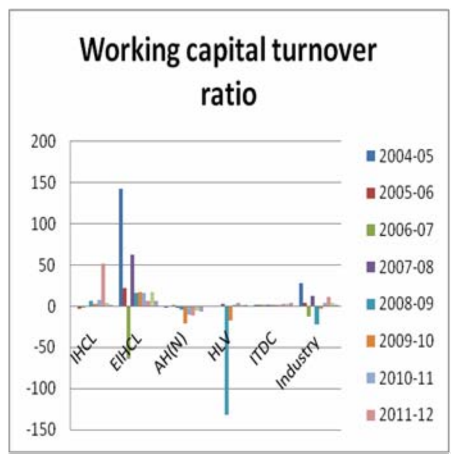
Working Capital Turnover ratio:

Working capital turnover provides some useful information as to how effectively a company is using its working capital to generate sales. This ratio is shown as

$$\text{Working Capital turnover ratio} = \frac{\text{Net sales}}{\text{Net working capital}}$$

It is the most widely used ratio for judging liquidity of business when establishes the relation between current assets and current liabilities. It measures the short term debt paying ability of a business.

Figure 2: working capital turnover ratio



Above figure show the working capital turnover ratio. Table reveals that, EIHCL hotels has high working capital turnover ratio i.e. 24.30 which indicate high efficiency of working capital utilization. This is good indication of satisfactory working capital management. Asian hotels and leela venture has negative working capital turnover ratio which indicates bad management of working capital. This shows that management has not utilized the working capital efficiently. Even IHCL and ITDC should improve the proper utilization of hotels. Table shows that most of the hotels have invested more on current assets.

Cash – Turnover Ratio:

This is an important ratio of controlling cash. It is reveals of effectiveness with which cash is utilized. Cash and bank balance is a paramount need of business firm for its day to day operations A high cash turnover ratio suggest better management of cash bust too high ratio which may be due to the lower level to cash is not appreciated. Cash turnover ratio has been computed by dividing the cash and bank balance by current liabilities.

Table 7: Cash turnover ratio

Year	IHCL	EIHCL	AH(N)	HLV	ITDC	Industry
2004-05	10.51	30.21	6.41	25.96	1.50	14.92
2005-06	8.93	33.71	74.68	11.11	1.63	26.01
2006-07	11.32	19.19	66.79	35.87	1.54	26.94
2007-08	8.77	28.52	74.02	10.90	10.31	26.51
2008-09	14.81	29.70	26.45	65.07	8.78	28.96
2009-10	22.10	37.04	144.84	22.60	13.55	48.02
2010-11	6.85	18.35	170.05	61.70	12.34	53.86
2011-12	8.72	13.65	81.86	74.68	18.90	39.56
2012-13	2.78	14.62	85.54	88.60	19.45	42.20
2013-14	1.80	21.10	71.24	5.00	2.59	20.35
MEAN	9.66	24.61	80.19	40.15	9.06	32.73
S.D	5.81	8.24	48.24	29.98	7.06	12.56
C.V	60.16	33.47	60.16	74.66	77.90	38.36

Table 7 shows the cash turnover ratio of selected hotels which has been calculated to assess the velocity of cash in the selected hotels. Study reveals that IHCL and ITDC average CTR is much lower than industry average CTR. This shows that IHCL and ITDC have failed to use the cash and bank balance judiciously. The EIHCL position is also not so satisfactory as compared to industry average. However, as the performance of other selected hotels is concerned, all have higher average CTR as compared to industry average. Further, IN assian hotels and leela venture, this ratio is very high than industry ratio. High C.V. indicates that there is high fluctuating trend in this ratio. Thus these hotels need consistency to maintain their better record.

Conclusion:

The current ratio of the selected hotel companies showed highly fluctuated trend during the study period. The quick ratio of India Tourism Development Corporation Limited showed that during the study period company could not maintain the quick ratio according the norms. The ratio was higher than the standard norms of 1:1 during the period of study. This is not advisable. It may lead in facing certain difficulties in meeting their current obligations.

Current ratio and liquid ratio reveals that EIHCL and Asian hotels are having the problem of liquidity. Asian hotels and EIHCL are suggested to improve their liquidity position. Other hotels are maintained a reasonably good liquidity position. Working capital turnover ratio indicates that except EIHCL other hotels should utilize the working capital judiciously. ITDC should review its collection policies and make more efforts to improve liquidity position and profitability. There is need of standard collection policy for quick collection of debt.

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