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A STUDY ON FINANCING PATTERN OF WORKING CAPITAL IN SELECTED COMPANY IN INDIA

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ABSTRACT

Every problem in industry or company has an important bearing on finance. Every attempt is, therefore, made for making certainty the judicious management of finance. In practice, investment, operations and earnings fluctuate. Consequently, financial structure or pattern also changes. Mode of finance conducing to a company's objective of earnings and continued existence is, therefore, very important for assessment of finance. The circumstances induce a company or an industry to undertake structural changes. Importance given to an individual objective in raising finance differs from units to units. As a financial policy, nobody can generalize that working capital should always be financed from specific source because different units have to face different economic situations. Availability of funds in appropriate quantity and variety may be difficult to achieve. Administration of working capital along with fixed capital is very important as short-term survival is a pre-condition for long-term success. Hence, the financing pattern of obtaining finance in a company or in an industry is a compromise of several criteria. This paper attempts to ascertain the size of short-term financing used to finance current assets along with the relative contribution of various sources in the context of Tata Motors Ltd., the reputed company in India.

INTRODUCTION

Financing of capital in general and working capital in particular plays a vital role in the successful and efficient working of every unit or industry. It is imperative on the part of management to decide the level of working capital. With the increase in the volume of operation, the demand for working capital increases and vice versa. The components required for constituting the working capital determine the mix of long-term and short-term funds for financing them. Sometimes it is found that each company maintains permanently a minimum of net working capital. In such cases, working capital is financed by long-term sources. Management will decide the extent to which the total current assets (i.e. gross working capital) should be financed by long-term or short-term or both. No specific rule can be prescribed for identifying the sources of funds to be utilized for financing working capital. Keeping in view the constraints of individual company or industry, a judicious proposition of short-term and long-term funds should be used for financing the working capital which will bring about parity between the assets and liabilities as well as between the return on equity and the cost of using the funds for financing the working capital. Finance manager should formulate working capital financing policy.

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Objective of the Study

The study aims at the following objectives:

- To examine the size of short-term financing used to finance current assets, one of the important aspects of financial management.
- To evaluate the relative contribution of various sources in the context of the selected company and the practice followed by the said company.

Data and Methodology

The researcher being an external one has to depend mainly upon secondary data for the examination of financing pattern of working capital of Tata Motors Ltd., the largest manufacture in Indian automobile industry. Hence, the data required for the study have been collected mostly from the annual reports and accounts of Tata Motors Ltd. The analysis has been done on the basis of the above-mentioned data.

The latest year for which data are available is 2014-15. The analysis, therefore, confines itself to the period from 2010-11 to 2014-15. The data for the period form 2010-11 to 2014-15 have been taken in order to study the change in financial pattern of working capital over a period of 5 years i.e. from 2010-11 to 2014-15. Moreover, calculations have been made scrupulously. The study is organized into four phases. Phase-I relates to the introduction of Tata Motors Ltd., the selected undertaking. Phase-II examines the size of short-term financing used to finance current assets with the help of the ratio of current liabilities to current assets which is synonymous to current ratio. Phase-III has made an attempt to present the proportion of various sources of short-term financing. The technique followed for the study is ratio analysis. In addition, editing, classification and tabulation in the financial figures have been done as per the requirement of the present study. Lastly, Phase-IV contains the concluding observation where the contribution of short-term financing amongst its various sources or components has been observed and our attention has also been focused on the general principles of financing.

Limitations of the Study

Limitations are always a part of any kind of research work, as the work is mainly based on secondary data; due care must be kept in mind in judging the limitations of the study. The major limitations are:-

- The financial pattern of the company is shown just for the last five years ending 2014-15. The latest data available is for the year 2014-15. Hence, any uneven trend before or beyond the said period is a major limitation of the study.
- The analysis is restricted to one selected company.
- The study is confined to only analyze the financial pattern of the selected company.
- The inherent limitation is secondary data. The published data does not always maintain uniformity and is not also properly exhibited by the company. Therefore, this may be taken as another limitation of the study.
- Due to non-availability of non-monetary data, the study is based on monetary information.
- Some data have been grouped and sub-grouped to suit our study purpose.
- There is also non-availability of sufficient literature and information from the company.

Phase – I

An Introduction to Tata Motors Ltd

Tata Motors established in 1945 is India's largest automobile company and is the world's fourth largest truck manufacturer and the world's second largest bus manufacturer. The company's employees are influenced by the vision to be best in the manner in which they operate, best in the products they deliver and best in their value system and ethics. Tata Motors has also emerged as an international automobile company and started exports since 1961. The foundation of the company's growth has stimulated economic and customer needs in India and abroad through R&D centres. Tata Motors in May, 2009 ushered in a new era in the Indian automobile industry and in its power, speed, carrying capacity, operating economy and trims, it will introduce new benchmarks in India and match the best in the world in performance at a lower life-cycle cost. In addition, its R&D is also focusing on environment-friendly technologies in emissions and alternative funds. The company plays an active role in community development, serving rural communities. Tata Motors is committed to Corporate Social Responsibility in compliance with the principles of the United Nations Global Compact and has received several awards like Good Corporate Citizen Award, National Award for Successful Commercialization of Indigenous Technology, National Award for R&D Efforts, Regional Top Exporter's Trophy, Best Company Award at Work skills Competition, EEPC Award for Tata Engineering etc.

Phase – II

Analysis of Financing Pattern

The analysis of the problem mentioned above has been done as under:

With a view to ascertaining whether or not current liabilities are sufficient to finance current assets, net working capital position of Tata Motors Ltd., the selected company has been assessed and exhibited in TABLE-I. From TABLE-I, we find that current liabilities always exceed current assets in the company for all the five years of study. The negative net working capital position (i.e. excess of current liabilities over current assets) in the company for all the years with an average negative amount evidences that short-term financing has been applied to finance the entire current assets and the remaining balance has been diverted for financing fixed assets. But net working capital figures do not show the extent to which current liabilities are used to finance current assets. The decision with regard to financing current assets by judicious combination of short-term and long-term sources is, however, suitably based on three important considerations, viz. risk, cost and flexibility. Current assets have the possibility of fluctuations.

As such, financing from short-term sources has more flexibility in repaying short-term loans than long-term loans. Interest cost on long-term loan is relatively stable over time; so short-term sources become riskier. In addition more reliance on short-term sources may cause failure on the part of a company to repay its short-term obligations. Cost of financing from short-term sources is usually higher than long-term sources. Of late, most of the companies in India are inclined to issue debenture for financing the entire capital or at least a major part of their working capital. TABLE-I shows that current liabilities are always higher than current assets. On an overage, current liabilities are more than twice (211.93%) the current assets which indicate that a certain portion of current liabilities are being used for financing fixed assets after meeting the full financial requirements of current assets. TABLE-I also shows that the computed ratios (figures in parenthesis) are more than 100% for all those negative working capital figures. The use of huge amount of excess of current liabilities over current assets for financing non-current assets increases from 2010-2011 to 2014-2015 indicating aggressive financing policy followed by Tata Motors Ltd. Current liabilities to total funds ratios have also increased over time from 53% to 68.9%. On an average this ratio is 64% (TABLE-III). TABLE-III shows that return on equity has significantly downward trend from 2010-2011 to 2013-2014.

The position in 2014-2015, due to reported net loss is alarming. On an average, the ratio is negative. Current ratio is below the conventional ratio of 2:1. Tata Motors Ltd. is no where near the conventional ratio or industry practice of 1.45 to 1.50 to 1 which indicates that the company fails to meet the immediate maturing obligations i.e. current liabilities. Quick ratio or liquid ratio shows a gloomy picture. On an average, 28% of current liabilities can be met from current assets. Now, the question is what are the sources of finance of Tata Motors Ltd to meet its maturing obligations? It may be possible in two ways. The company can extend its credit period or the company can meet its obligations from long-term sources of finance. Extension of credit period can badly affect the reputation of the company and such extension can add an additional amount of cost charged by suppliers of goods and services. In either cases such incident does not seem to be desirable.

financing the non-current assets and a minor part is utilized for financing current assets. This happens so that the remaining portion is financed by current liabilities or short-term liabilities. The above practice may differ from industry to industry and from company to company. Positive net working capital signifies higher of current assets than current liabilities. From financing point of view, negative net working capital i.e. higher of current liabilities than current assets may also occur. In such case, current liabilities are not only used for financing the entire current assets but also a portion of non-current assets. A company following aggressive financing policy supports this pattern although this pattern increases the risk. A cursory glance at TABLE-III shows that debt-equity ratio has gradually declined from 75% in 2010-2011 to 61% in 2013-2014. In 2014-2015, the ratio has improved significantly (99%) when the return on equity shows negative figure.

Table1 .Net working capital position of Tata Motors Ltd., the selected company under study (Rs. in crore)

2010-2011	2011-2012	2012-2013	2013-2014	2014-2015	Average
- 8028.57 (173.18)	- 8464.55 (161.73)	- 10969.65 (208.23)	- 12058.47 (278.90)	- 11797.66 (237.61)	- 10263.78 (211.93)

Notes:

1. Figures in parenthesis indicate the ratio of current liabilities to current asset in %.
2. Source:- Annual Reports, Results computed.

Table 2. Proportion of various sources of Short-term financing of Tata Motors Ltd., the selected company under study (in %)

	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015	Average
A	26.10	13.56	29.46	25.37	38.10	26.52
B	46.41	39.43	40.06	51.46	43.46	44.16
C	10.60	13.32	7.15	10.07	3.01	8.83
D	16.90	33.69	23.33	13.10	15.43	20.49

Notes:
1. 'A' indicates the ratio of short-term borrowing to current liabilities.
'B' indicates the ratio of trade payables to current liabilities.
'C' indicates the ratio of short-term provisions to current liabilities.
'D' indicates the ratio of miscellaneous current liabilities to current liabilities.
2. Source: Annual Reports, Results computed.

Table-3. Statement showing other relevant ratios of Tata Motors Ltd., the selected company under study for financing working capital (in %)

Particulars	2010-11	2011-12	2012-13	2013-14	2014-15	Average
Current Ratio	58	62	48	36	42	49
Quick Ratio	37	41	27	15	19	28
Debt-Equity Ratio	75	65	62	61	99	72
Current Liabilities to Total Funds Ratio	53.0	68.6	67.9	60.8	68.9	64.0
Return on Equity Ratio	9.05	6.33	1.58	1.74	(-) 31.89	(-) 2.64

Notes:
1. Quick Ratio:
(Current Assets - Inventories) /
Current Liabilities x 100
Total Funds: Long-term Liabilities + Equity
Return on Equity Ratio = Reported Net Profit/Shareholders' Fund x 100
2. Source: Annual Reports, Results Computed

A reference to debt-equity ratio and current liabilities to current assets ratio may provide a picture of financing policy of Tata Motors Ltd. A lower cost of debt and higher rate of return on equity can be adopted so long the rate of return is higher than the cost of debt. In India, financial institutions like IDBI, IFCI etc. usually follow a norm of 2:1 ratio for financing in the private sector whereas a norm of 1:1 ratio for public sector. For determining the financing pattern of current assets by short-term vs long-term sources, usually a major part of long-term sources (e.g. debt, equity etc.) is utilized for

On an average, the ratio is 72%. Tata Motors Ltd.'s dependence on current liabilities for financing total funds exhibits a high ratio of 64%. Dependence on current liabilities for financing total funds has increased from 53% in 2010-2011 to 68.9% in 2014-2015 which indicates that Tata Motors Ltd. has been forced to depend more on the short-term sources by following aggressive financing policy. This enhances financing risk which not supported by reasonable return on equity is usually against the principle of financial management.

Phase – III

Short-term Financing

The above analysis explains the size of current liabilities used to finance current assets. Now, an attempt has been made to determine the sources of short-term financing which are:- (a) Short-term borrowings; (b) Trade payables; (c) Short-term provisions and (d) Miscellaneous current liabilities. TABLE-II exhibits the proportion of these various categories to current liabilities. Short-term borrowings are considered a common source of industry loans. Manufacturing concerns particularly use bank credits extensively. In advanced countries like U.S.A., bank credits play a vital role as source of finance. Bank credit is a scarce national resource which needs to be used efficiently so as to achieve optimum credit multiplier. The ratio of short-term borrowings to current liabilities has been computed in column 'A' of TABLE-II. These ratios indicate that the size of short-term borrowings varies from 13.56% in 2011-2012 to 38.10% in 2014-2015. On an average the ratio is 26.52%. Successful business operations give risk not only to the needs for credit but also to certain significant sources of credit (i.e. inter-firm) trade payables or trade credit. By nature trade credit or trade payable is self-generating or spontaneous. In India trade credit occupies a predominant position in current liabilities which are used for financing working capital. Traditionally, repayment of this type of credit on due date has zero cost assumption. For this, businessmen, substitute this finance for bank credit when the availability of latter is constrained, stringent, or costly. Actually, trade payable or trade credit is a short-term credit extended by a supplier to a buyer in conjunction with the purchase of goods for ultimate resale. We find from TABLE-II (Column-'B') that the size of trade payables varies form 39.43% in 2011-12 to 51.46% in 2013-14. On an average, the ratio is 44.16%. The other two categories namely, short-term provisions and miscellaneous current liabilities also play a vital role in short-term financing. Regarding provision, it is found that the amount earmarked as provision varies from 3.01% in 2014-15 to 13.32% in 2011-12. Moreover, it is evident from TABLE-II (Column-'C') that the size of provisions has declined significantly in 2014-15 over 2010-11 for the company under study. On an average, the ratio is 8.83%.Lastly, the size of miscellaneous current liabilities ranges from 13.10% in 2013-14 to 33.69% in 2011-12. This ratio has declined from 16.90% in 2010-11 to 15.43% in 2014-15. On an average, the ratio is 20.49%. A study of various sources of short-term financing of Tata Motors Ltd. evidences that on an average, the size of trade payables is highest followed by short-term borrowings, miscellaneous current liabilities and then short-term provisions.

Phase-IV

Concluding Observation

Considering all the years together, it has been observed that except for the year 2011-2, in all the remaining years of study trade payables or trade creditors hold the largest share followed by short-term borrowing, miscellaneous current liabilities and short-term provisions. In 2011-12, the largest share is trade payables or trade creditors followed by miscellaneous current liabilities short-term borrowings and short-term provisions. On an average also, the largest share of financing is trade payables followed by short-term borrowings, miscellaneous current liabilities and short-term provisions. From the above, it can be concluded that the major source of short-term financing in the selected company in India has been observed to be trade payables and short-term borrowings. The above analysis also shows that Tata Motors Ltd, the selected company in India does not violate the general norm of finance as is evident from TABLE.

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