

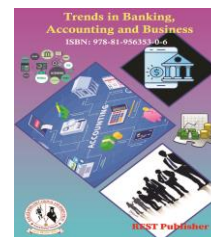


## Trends in Banking, Accounting and Business

Vol: 3(1), 2024

REST Publisher; ISBN: 978-81-956353-0-6

Website: <https://restpublisher.com/book-series/tbab/>



# A Study on Working Capital Management in Indian Oil Corporation Limited at Chennai

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**Abstract:** Working capital management is a vital financial decision which makes a positive contribution to creating value for the company. Every company requires investment in the procurement, and for a longer period of time, of fixed assets. Money invested in these assets is known as 'Long-Term Capital Funds.' In order to finance current activities, Business often requires short-term funds. The term "Short-term Funds," or 'Working Capital,' means short term investment in assets such as cash, inventories and debtors. The working capital can be classified as funds necessary for the smooth running of day-to-day activities of the company. Therefore, the position of the finance manager is critical and is committed to the effective and productive retention of business activities. Mismatch if any does not only result in negative impact of profitability and company in the effective management of current assets and liabilities. Mismatch, if any, would not only have a detrimental impact on profitability and development but would also have a financial distress and a bankruptcy of the company in successful handling of current assets and liabilities. This study considering the significance of the above, shall make an attempt to investigate the efficiency of working capital management of public sector company and its relationship with profitability and net worth. Further, the study would also overcome limitation of scholastic knowledge due to dearth of research in financial management at the public sector undertaking. The tools used for analysis and interpretation are Ratio Analysis, DuPont Analysis, Comparative Balance Sheet Statement, Trend Analysis. In this study I studied the working capital management of IOCL Ltd. The analysis comprises a realistic and conceptual perspective on current asset decisions such as cash and Bank balance, inventories, sundry debtors, advances and loans, other assets and liabilities such as sundry creditors, securities and other deposits, as well as on current liabilities and Arrangements made by IOCL.

**Key Words:** Working capital, ratio analysis, DuPont Analysis.

## 1. INTRODUCTION

Working capital management refers to the working capital decisions. It involves the administration of the relationship between the short-term assets and liabilities of a company to ensure that the cash flow is adequate to cover short-term debt and operating expenses. Working capital is essential to the health of every business and improving your working capital position can provide a boost to the operational efficiency of a business, but managing it effectively is something of a balancing act. By improving the way, they manage working capital, companies can free up cash that would otherwise be trapped on their balance sheets. As a result, they may be able to reduce the need for external borrowing, fuel growth, fund mergers or acquisitions, or invest in R&D. Working capital management should always ensure that the business has enough liquid assets to meet its short-term obligations, often by collecting payment from customer's sooner or by extending supplier payment terms. Unexpected costs can also be considered obligations, so these need to be factored into the approach to working capital management, too.

## 2. REVIEW OF LITERATURE

Anand Manoj (2012) investigated 81 big Indian companies, chosen based on market capitalization, to find out corporate finance practices such as capital budgeting decision, capital structure decision and dividend policy decision. Most respondents used NPV and IRR as their most frequently used evaluation tools. Eighty-five per cent of the respondents considered IRR as a very important/ important project choice criterion. The level of popularity for NPV

method was about 65 per cent only. The Payback Period method was also popular (67.5%). The most interesting results came from examining the responses conditional on firm size and growth characteristics. Large firms were significantly more likely to use NPV than small firms. Small firms were more likely to use payback period method than large firms. High growth firms were more likely to use IRR than the low growth firms, whereas low growth firms are more likely to use break-even analysis than high growth firms. Gupta Sanjeev et al. (2017) conducted a survey of Capital Budgeting Practices in Punjab based companies to examine influence of factors like size of capital budget, age and nature of the company, professional qualification of CEO. They observed that majority of sample companies were still using non-discounted cash flow technique mostly Payback Period criteria to evaluate new project. These findings are surprising that while corporate houses in developed countries are trying the latest sophisticated methods, the sample companies are still practicing traditional unscientific tools. Only a few companies were seen to use DCF and among them a very negligible number of companies were found to apply NPV. The companies used WACC for determining the discounting rate needed for discounting of future payoffs. Shah Kamini (2018) found that almost all the companies are using now multiple techniques for evaluating their capital budgeting proposals. The researcher also observed that the companies prefer 'IRR and NPV' to Payback period method. Interestingly she observed two different trends in choosing evaluation tools. She noted that for investing in new projects firms use IRR, PBP and NPV, while for expansion, replacement, modernization, etc., firms largely rely on Payback period method. She also found Sensitivity analysis as the most important technique for risk analysis and scenario analysis as the second most important technique for this purpose. Verma, Gupta and Batra (2019) made a survey of 30 India companies from manufacturing sector. The authors observed that globalization and exposure of Indian companies to global competition have compelled to be more judicious and rational in making capital budgeting decisions. These companies were seen to apply formal capital budgeting analysis including DCF to avoid any mistakes resulting in losses. The authors also observed that, instead of relying on one single technique of evaluation, the companies were seen to try multiple appraisal methods for evaluation of investments. They noted the emergence of a trend of increased adoption of sophisticated discounted capital budgeting tools like NPV and IRR as compared to the non-DCF capital budgeting techniques. However, majority of companies exhibited their preference for Payback Period Method as a supplementary method as well as primary method. Singh, Jain and Yadav (2020) studied the contemporary practices in capital budgeting in Indian companies. Result of the study is based on responses received from 31 nonfinancial companies listed in BSE 200 index. All responding companies used Discounted Cash Flow (DCF) techniques along with non-DCF techniques. There was a strong preference for DCF, in which more than 78.57 percent preferred IRR instead of NPV. This is contrary to textbook prescription that NPV is better than IRR; survey results reveal that firms exhibited a preference for IRR compared to NPV. The authors found sizeable percentage of companies to follow non-DCF methods such as Payback period (64.28 percent) and Accounting Rate of Return (39.28 percent). They also noticed that sensitivity analysis was the most widely used tool for handling risk in capital budgeting decision-making. The study reports the emergence real option analysis such as re-investment options (50 percent) and abandonment options (17.64 percent).

### 3 ANALYSIS AND INTERPRETATION OF DATA

#### Ratio analysis:

##### Current ratio:

The current ratio is balance-sheet financial performance measure of company liquidity.

The current ratio shows the ability of an organization to fulfill short-term debt obligations.

The current ratio tests whether a company does or does not have sufficient capital to cover its obligations over the next 12 months.

Potential lenders use this ratio to determine whether shortterm loans are to be made or not. The current ratio may also indicate the productivity or the capacity of a company to transform its commodity into cash.

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

**TABLE 1.** Current ratio

Year	Current Ratio
2020	0.69
2021	0.73
2022	0.75
2023	0.74

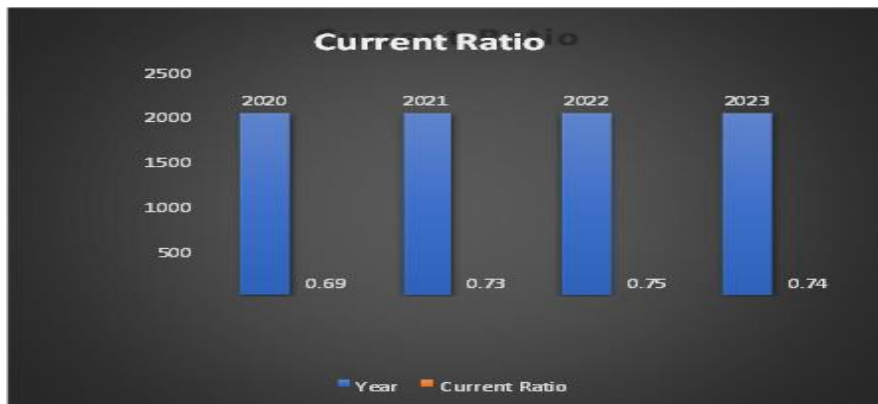


FIGURE 2. Current ratio

TABLE 2

U	1	2	3	4
■ Year	2020	2021	2022	2023
■ Current Ratio	0.69	0.73	0.75	0.74

**Significance**

This reveals that the current ratio of 0.69 was low in 2020 and 0.75 was high at 2022. According to the decrease in liabilities, the present annual figure for 2023 was considered to be the second highest (0.74).

**Quick Ratio**

The quick ratio of the ability of a company to fulfill its short-term obligations through most liquid assets (near cash or quick assets).

Quick assets include current assets which can be transformed easily to cash near book values.

The quick ratio is seen as a sign of financial strength or weakness of a company; it provides details about short-term liquidity of a company.

$$\text{Quick Ratio} = \frac{(\text{Current Assets} - \text{Inventories})}{\text{Current Liabilities}}$$

TABLE 3.

Year	Quick Ratio
2020	0.291
2021	0.234
2022	0.227
2023	0.217



FIGURE 3. Quick Ratio

**TABLE 4**

0	1	2	3	4
■ Year	2020	2021	2022	2023
■ Quick Ratio	0.291	0.234	0.227	0.217

**Significance:**

This reveals that the quick ratio of 0.291 was high in 2020 and 0.217 was low in 2023. According to the increase in liabilities, it shows the company can't able to pay back the liabilities. The higher the quick ratio, the better the company's position. The generally appropriate current ratio is 1, but is subject to different business environment. A company with a quick ratio of less than 1 can't repay its current liabilities at present; that is the bad sign to investors and partners.

**Debtors turn-over ratio:**

- It also called as a Receivable Turnover Ratio, Debtors turnover ratio indicates the velocity at which a company collects debt, and the average number of times over a year.
- This ratio measures how fast a company collects its customers' outstanding cash balance over an accounting period.
- It is a vital measure of the financial and operating advantage of the company and can be used to assess if a company has trouble obtaining credit sales.

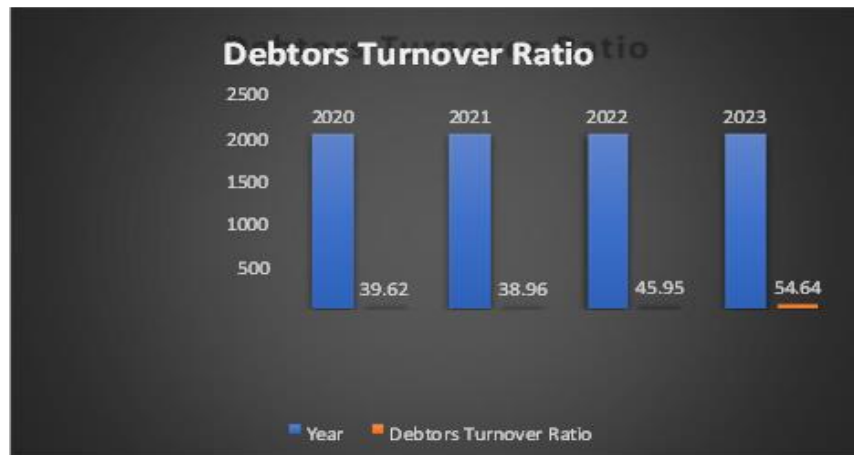
$$\text{Debtors Turnover Ratio} = \frac{\text{Net Credit Sales}}{\text{Average Accounts Receivable}}$$

**TABLE 5.** Debtors turn-over ratio

Year	Debtors Turnover Ratio
2020	39.62
2021	38.96
2022	45.95
2023	54.64

$$\text{Net Credit Sales} = \text{Total Sales} - \text{Sales Return} - \text{Sales Allowances} - \text{Cash Sales}$$

$$\text{Average Accounts Receivable} = \text{Opening Balance} + \text{Closing Balance} / 2$$



**FIGURE 4.** Debtors turnover ratio

**TABLE 6**

0	1	2	3	4
■ Year	2020	2021	2022	2023
■ Debtors Turnover Ratio	39.62	38.96	45.95	54.64

**Significance:**

This reveals that the debtor’s turnover ratio of 54.64 was high in 2023 and 38.96 was low in 2021. When the debtor’s turnover is higher the more efficient is the management of debtors or more liquid the debtors are, the better the company is in terms of collecting their debts. Likewise, the low turnover ratio for debtors means inefficient debtor management or less liquid debtors management. But in some situations, too high a ratio may suggest that the credit lending policies of the business are too rigorous to discourage prime borrowers from being customers.

**Inventory turnover ratio**

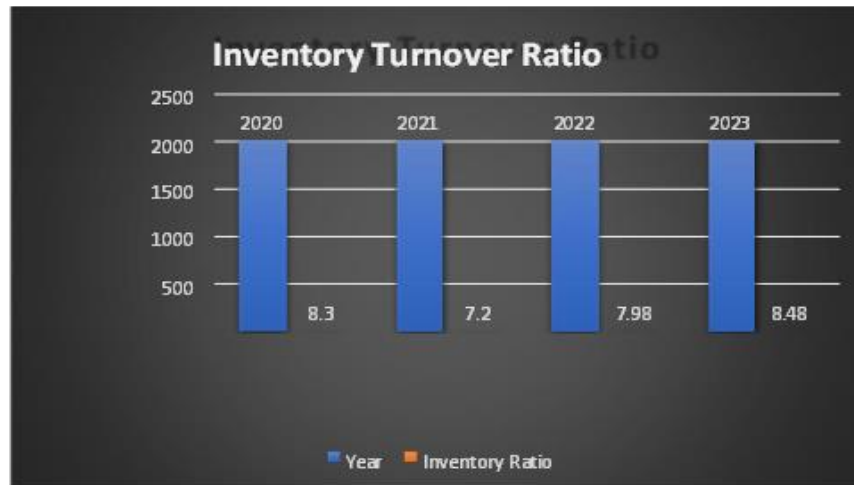
Inventory turnover is a measure of how many inventory periods a time span such as one year is sold or used. The quality of the stock is good (whether the inventory is obsolete or not), effective shopping and inventory management are good indicators.

This ratio is significant as each inventory is returned with gross profit. It is also called Stock turnover.

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

**TABLE 7.** Inventory turn-over ratio

Year	Inventory Turnover Ratio
2020	8.30
2021	7.20
2022	7.98
2023	8.48



**FIGURE 5.** Inventory Turn-Over Ratio

**TABLE 8**

0	1	2	3	4
Year	2020	2021	2022	2023
Inventory Ratio	8.3	7.2	7.98	8.48

**Significance**

This reveals that the Inventory turnover ratio of 8.48 was high in 2023 and 7.20 was low in 2021. Ineffective inventory management (that is, keeping an inventory too large) and poor sales or inventory performance may cause a relative low inventory turnover to avoid deleting inventory losses against income. A high number normally implies increased sales productivity and a lower risk of loss due to inventory. Too big a role in inventory which is out of line with industry standards may, however, indicate loss from scarcity and poor customer service.

**Debt equity ratio**

The debt equity ratio is used to gauge the company’s capability to pay back its obligations.

It basically shows the overall health of a particular company.

In case if the debt-to-equity ratio is higher, the company is receiving more financing by lending money subjecting to risk, and if potential debts are too high, there are chances of the company getting bankrupt during these times.

$$\text{DEBT EQUITY} = \frac{\text{Total Liabilities}}{\text{Total Shareholders' Equity}}$$

**TABLE 9.** Debt equity ratio

Year	Debt Equity Ratio
2020	1.16
2021	0.85
2022	0.84
2023	0.98



**FIGURE 6.** Debt Equity Ratio

**TABLE 10**

0	1	2	3	4	5
■ Year	2020	2021	2022	2023	
■ Debt Equity Ratio	1.16	0.85	0.84	0.98	

**Significance**

This reveals that debt equity ratio of 1.16 was high in 2020 and 0.84 was low in 2022. A high debt equity ratio indicates that a company is borrowing more capital from the market.

**4. FINDINGS**

1. The company having uncomfortable working capital position.
2. The absolute liquidity of the IOCL is in favour.
3. The collection policy of the company is very good.
4. This is an improvement in collection policy of the IOCL.

**5. SUGGESTIONS**

The recommendation & proposal for successful working capital management at IOCL Ltd is as follows:

IOCL can reduce inventory by relying on phasing-in production i.e., production on requirement and disposal or

recycling of inventories which are not useful to improve its position. However, inventory turnover can also be caused by issues with revenue generation. Inventory management, particularly shops and spares, is a major concern of IOCL. In order to obtain inventories, the buying manager should take appropriate measures. In order to lower the working capital cycle, the organization must take some measures. Inventory control can be improved one way. IOCL is recommended to maintain the capacity balance and to synchronize the supply of different inputs with materials or parts not available easily.

## **6. CONCLUSION**

The thesis concludes with the findings that although Indian Oil is having a huge market share and is known as a major in Petroleum sector but due to advancement in technology; entrance of new competitors; maturity of the stagnant business, but then also a company should keep eyes on market and its competitors which IOCL is generally doing but as per the research it.

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