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Analysis of Working Capital Management of Hero MotoCorp Limited

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Abstract

All business ventures need assets to run themselves. Assets are the owned resources of the company which are used to carry its business. These assets are divided into two broad categories, by the virtue of their life span. Those assets which are meant to continue in the business foe ever, are called as fixed assets and remaining assets having life of either one operating cycle or of one accounting year, are known as current assets. Working capital is concerned with current assets only. Working capital is the total of current assets employed in the business. Working capital is also known as the amount needed for conduct of day to day business activities. Working capital is much required to take advantage of the fixed assets of the business.

Working capital takes care of the various payments need to be done, in order to continue the operating cycle and to conduct the business successfully. Working capital is necessary to maintain the liquidity in business. Working capital management is the management of various components of the current assets such that all business obligations are met on time. Effective and efficient management of working capital ensures profitable running of business. Working capital management would imply the management of various constituents of working capital, in a cost effective manner. Various components of working capital have a cost to the company and mismanagement of any component of current assets would land the company in trouble. Management of working capital also gains the importance due to the fact that it involves substantial amount of funds, at least in the large manufacturing organization, like Hero Moto Corp Limited. Hero Moto Corp Limited (HMCL) is a leading two wheeler manufacturer in India. HMCL is the world's largest manufacturer of two wheelers since last 18 years with presence in 37 countries on the globe. HMCL is about to touch a production capacity of 11 million units per annum. With this much production capacity, it is obvious that HMCL must be requiring huge amount of working capital. Thus, it would be prudent to study working capital management of HMCL.

Keywords: Working capital, current assets, current liabilities, gross working capital, net working capital, working capital turnover ratios.

Introduction

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Every business is started with some investment. The resources so invested are used to create assets for the business. These assets are used to establish the business and then to carry the business profitably. These assets are owned by the company and used by the company either in rendering the services to the customers or to manufacture the products. It can be said that assets are the resources owned by the business which are used to generate the business. In the process of conducting the business, some assets get consumed while some are used in the transformation process and some stay there in the business for ever. On this basis only, the assets are categorized as fixed assets and current assets. The assets which stay in the business forever as known as fixed assets, like land, building, machineries, equipments, fixtures etc. Rest of the assets which are there in the business either for one operating cycle or for one accounting cycle are called as current assets. For example, raw material, finished goods, cash, bank balance, receivables etc. Working capital is concerned with current assets only. Current assets are the assets which are used to carry day to day operations of the business. In the absence of current assets, it is not possible to utilize fixed assets even. Also that in if there will be no current assets, no production would be possible. No sales can happen in the absence of finished goods. Payments cannot be made if there is no cash in the organization. Thus, in simple words, the business runs on current assets only and that is what constitutes working capital of the organization. The management of working capital ensures continuous profitable running of the business. This includes buying of raw material at most cost effective rate, using it in most efficient manner, carrying the raw material inventory in most desirable way, engaging least work in process material, immediate selling of ready material on cash basis and if it is sold on credit

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basis, fast recovery of receivables. Management of working capital also implies that minimum funds are engaged as working capital as the funds do have their own cost. Another dimension of investing unnecessary amount as working capital would mean an increase in the total of assets in the balance sheet which would also force the liabilities to increase. Increase in liabilities in correlation with non performing assets is not a good financial feature for any organization.

Founded in 1984 by Mr. B. L. Munjal as joint venture between Hero Cycles and Honda from Japan, as Hero Honda, Hero Moto Corp Limited (HMCL) is the world's largest two wheeler manufacturer since last 18 years consecutively. HMCL has presence in 37 countries and it has over 90 million satisfied customers across the globe. HMCL is having a dominant 50% share in Indian two wheeler market. HMCL has five manufacturing plants in India and one each in Bangladesh and Columbia, with a combined manufacturing capacity to touch 11 million units per annum. It had sales turnover of Rs 33,972.33 Corers in the year 2019.

Objectives of the present study

Research discovers the answer to specific questions using scientific procedures. The objective of research is to find out undiscovered fact which is still hidden. Every research is carried on with specific purpose, which guides the research. No research study can be conducted in the absence of pre determined objectives. Objectives direct the research. The present study is undertaken with following objectives:

(i) To understand working capital.

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(ii) To understand concepts of working capital.

(iii) To understand working capital management.

(iv) To calculate WCM ratios of Hero Moto Corp Limited.

(v) To analyze and interpret WCM ratios of Hero Moto Corp Limited.

Research Methodology

The research methodology is important to be considered by any researcher as if a wrong method is adopted to carry the research, even a very effective research can go in vain. By following correct methodology only, the objectives of research can be achieved. For conducting the present study, secondary sources of data have been used. The required data has been collected from the website and annual reports of Hero Moto Corp, for the year 2015 to 2019. The methodology to conduct present study includes the use of simple mathematical techniques of calculating ratios and percentages, using the collected data and also the averages of the calculated ratios. The collected data and the calculated assets ratios are then presented in Table 1.

Scope of the study

The present study of analysis of working capital management ratios of Hero Moto Corp Limited is spread over five accounting years that is from the year 2015 to 2019. The study is confined to Hero MotoCorp Limited only.

Working capital – concepts, types and its management

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As already discussed, working capital is nothing but the total of current assets. Current assets have the life span of maximum one accounting year. Working capital is amount that is spent towards acquiring various current assets. If the total of all current assets is considered, the working capital is termed as gross working capital and if current liabilities are deducted from total current assets, the residual is known as net working capital. Net working capital is also defined as the excess of current assets over current liabilities. These two concepts i. e. gross and net are also known as Balance Sheet concepts of working capital. Both the concepts have their own importance. Gross concept gives a picture of total current assets and percentage of its components. It also provides the figure of total investment in current assets as working capital. This is helpful in minimizing the cost of funds, blocked as working capital. It also helps in analyzing the proportions of different components of working capital. The said rules of liquidity suggest that inventories should not cross the limit of 50% of total current assets and similarly, the amount of current assets should be double of the amount to be paid as current liabilities. Adhering to the suggested levels of current assets and current liabilities helps in maintaining the liquidity in the organization. Working capital is the total current assets which form the part of operating cycle. Operating cycle starts at cash and needs to end at cash and that too with an increased amount. This total of current assets engaged in operating cycle is also known as the operating cycle concept of working capital. With cash, raw material is purchased which enters into the transformation process, with cash payments are made for wages and other over heads, as well, including administrative, advertising, marketing etc. At the end of transformation process, finished goods are received and these are meant for sales. The product is needed to be sold for

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cash, which is the end of operating cycle. If the product is not sold for cash and it is sold for credit, then the endeavour should be to collect the cash at the earliest as to end the operating cycle. In case of credit sales, operating cycle gets stretched. This way the journey which starts with cash, ends with cash. The components of working capital involved in this are cash, bank balance, raw material and work in process material, finished goods and debtor which are the result of credit sales.

It is also understood that some amount of different components of current assets will always be there in the business irrespective of the level of operational activity. Tandon Committee referred to such assets as Core Current Assets. These are also known as hard core working capital. These are the assets needed by the organization to run the business in continuity. The total of these assets are known as the permanent working capital. These are the minimum amounts of current assets which would always stay in the business, just likes fixed assets. Permanent working capital is required to be funded through long term sources of finance like equity or long term debt. On the contrary, the temporary working capital depends up on the level of operational activity of the organization. With increase in the activity level, temporary working capital increases and with decrease, it decreases. Temporary working capital can be financed through short term sources of finance. Even advance from customers can be a source to finance the temporary requirement of working capital. This type of classification helps the finance managers to reach at the amount of working capital that needs to be financed through

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long term and through short term sources of finance. This relieves the managers of the pain of arranging the working capital every now and then.

Management of working capital means management of all its components for the efficient working of the organization. The management of working capital starts with the proper estimation of funds requirement for working capital itself. If excess funds are invested in working capital, the overall cost of funds will increase and if the working capital is less than the requirement, there would be stringency of funds in the organization. Thus, an optimum level of funds to be blocked as working capital is need to be worked out, balancing the need and the availability of the working capital components. Next step in the management of working capital is to acquire the raw material in adequate quantity. The quantity ordered need to be adequate so as to continue the business operations and at the same time there should not be any excess inventory of raw materials. If extra raw material is held as inventory, there are two issues. Firstly, it blocks money and secondly, the inventory needs to be carried on safely which involves carrying cost. Thus, it becomes imperative to optimize the quantity of raw material to be used, in order to minimize the total cost of funds involved in working capital. Next step would be to immediately sale the product as it would result in the revenue generation. If credit sales are made, the focus should be on speedy recovery of the amount from debtors. The overall length of operating cycle should also be kept at minimum required number of days as this would also help in efficient management of working capital. Thus, the ultimate objective of working capital

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management is the continuity of business operations through timely completion of operating cycle and to maintain the cost of working capital finance at the minimum.

Calculation of WCM ratios

The analysis of the utilization of various components of working capital is done through proportion analysis and ratio analysis. In proportion analysis the percentage of the particular item like cash and bank or inventory etc. in the total current assets. In ratio analysis, the relationship between components of current assets and of current assets with sales is calculated and analyzed. Proportion analysis is also useful from the view point of liquidity management of the company. The percentage of cash and bank, inventory, receivables etc. in total current assets is useful in analyzing the proper use of each rupee being invested as working capital. For analysis of management of working capital, turnover ratios are calculated, like gross working capital turnover ratio, net working capital turnover ratio, receivables turnover ratio, debt collection period, inventory turnover ratio etc. These ratios are calculated using following formulas:

$$Working\ capital\ turnover\ ratio\ (Gross) = (Sales / Gross\ working\ capital)$$

$$Working\ capital\ turnover\ ratio\ (Net) = (Sales / Net\ working\ capital)$$

$$Receivables\ turnover\ ratio = (Sales / Receivables)$$

$$Inventory\ turnover\ ratio = (Sales / Inventory)$$

Calculation of WCM ratios of HMCL

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Working capital turnover ratios are helpful in analyzing the efficiency with which the working capital and its components have been used by the company. The WCM ratios of HCML are calculated in Table 1.

Table 1: Calculation of WCM Ratios of Hero MotoCorp Limited

Rs in Crores

Particulars / Year	2019	2018	2017	2016	2015	Average
Sales*	33972.23	33100.94	30983.66	30715.33	27538.03	31262.03
Gross Working capital**	8413.21	9002.23	7570.51	6303.33	5548.30	7361.52
Total Current Liabilities	4409.18	4481.36	4176.69	3571.52	3389.64	4005.68
Net Working Capital***	4004.03	4520.87	3393.82	2731.81	2158.66	3361.84
Cash****	303.9	237.57	195.39	179.09	215.78	226.35
Accounts receivables	2745.11	1426.97	1551.75	1282.08	1371.82	1675.55
Inventory	1249.53	962.68	708.58	761.99	861.39	908.83
Sales to Gross Working Capital	4.04	3.68	4.09	4.87	4.96	4.33
Sales to Net Working Capital	8.48	7.32	9.13	11.24	12.76	9.79
Cash to Total Current Assets	0.04	0.03	0.03	0.03	0.04	0.03
Inventory to Total Current Assets	0.15	0.11	0.09	0.12	0.16	0.13
Receivables to Total Current Assets	0.33	0.16	0.20	0.20	0.25	0.23
Receivables Turnover Ratio	12.38	23.20	19.97	23.96	20.07	19.91
Debt Collection Priod (in Days)	29.49	15.74	18.28	15.24	18.18	19.39
Invemtory Turnover Ratio	27.19	34.38	43.73	40.31	31.97	35.52

Source: Website and Annual Reports of Hero MotoCorp Limited

* Revenue from operations

** Total current assets

*** (Total current assets minus total current liabilities)

Analysis and interpretation of WCM ratios of HMCL

For the purpose of analysis and interpretation of WCM ratios of HCML, Table 1 will be referred. As observed in Table 1, the average sales of HCML during the five accounting years of study have been Rs 31,262.03 Crores, highest being Rs 33,972.23 Crores in the year 2019. The

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noticeable thing is that the sales revenue has kept on increasing during the period of study, which is a good business sign. Similarly, working capital has also shown an increasing trend during three years of study but decreased in the year 2019. It can be seen that the proportion of increase in sales and in working capital is not proportionate. The reason could be time lag between making the sale and collection of cash, may be from banks and financial institutions who tender loan to the customers. Average current assets during the five years of the study period stand at Rs 7,361.52 Crores. Moving ahead to current liabilities, it can be seen that current liabilities have moved in the direction of current assets, which is a good sign of working capital management and the impact of this movement is also visible in net working capital. On average, current liabilities are Rs 4,005.68 Crores, during the period of study. Net working capital is calculated by deducting total current liabilities from total current assets. Net working capital of HMCL also exhibits the same trend as shown by current assets and current liabilities. Net working capital also increased from the year 2016 to the year 2018 and it decreased in the year 2019. Moving towards the analysis of components of current assets, as their respective proportion in the total current assets, it can be observed that cash has decreased in the year 2016 and then kept on increasing till the year 2019. The proportion of cash is only 0.03 in gross current assets, on average during the five year period of study. This proportion was 0.04 in the year 2015 and the year 2019, otherwise it was 0.03. This is very good sign of cash management by HMCL. As it is a large manufacturing organization, HMCL could have easily piled up cash but it’s good to observe that the cash management is really stringent at HMCL. The proportion of inventory in total current assets is also appreciable as it is 0.13 only, on average and the highest 0.16 in the

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year 2015 and 0.15 in the year 2019. The least proportion was 0.09 in the year 2017. The inventory is also being managed efficiently at HMCL. HMCL must also have succeeded in keeping the operating cycle at its optimum length. This helps in maintain the inventories at minimum. One more thing is observed here that HMCL has aggressive and correlated production and sales strategies as there are not inventories. However, looking at the proportion of receivables, HMCL needs to expedite its collection process. Receivables mounted to 0.33 in proportion to the total current assets in the year 2019 which can pose worry to the company. Average receivables were 0.23 during the period of study. The observable fact here is that the receivables increased by more than double in the year 2019, in comparison to the year 2018. These rose to 0.33 from 0.16, which should be a cause of worry for HMCL. It is observed that receivables are almost 0.25 portion of the total current assets. This is not advisable and HMCL need to rake care of it immediately.

Moving to WCM ratio analysis of HMCL, the sales to working capital ratio in times is 4.33 in average during the five year of study. The highest ratio was 4.96 in the year 2015 and it kept on decreasing till the year 2019. It is observed that the gross working capital has been utilized more than 4 times in generation of the sales revenue. Net working capital has been utilized better in comparison to the gross working capital in generation of sales revenue. The net working capital ratio was 9.79 times on average during the period of study and it was highest at 12.76 times in the year 2015 and lowest was 7.32 times in the year in the year 2018. The ratio kept on declining throughout the period of study. HMCL need to look into this matter and take

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corrective measures immediately, so as to maintain the gross and net working capital turnover ratios at higher level as these are showing decreasing trend. Receivables turnover ratio was as high as 23.96 times in the year 2016which decreased to 12.38 times in the year 2019. This is not a good sign of receivables management. High receivables turnover ratio also results in less debt collection period and vice versa. Thus, it can be seen that debt collection period rose to as high as 30 days in the year 2019 from 16 days in the year 2018. Here, the management needs to identify the reason for poor debt collection and to shorten the debt collection period. The lowest debt collection period was 16 days and that should be the benchmark HMCL should try to achieve. Inventory turnover ratios of HMCL are impressive and show that inventory is being utilized efficiently. The ratio was as high as s 4.73 times in the year 2017 but then it fell to 27.19 times. The average ratio was 35.52 times but HMCL must find out the reasons for low inventory turnover ratio in the year 2019. It is also observed from Table 1 that sales have increased in the year 2019 but gross working capital and net working capital decreased. Accounts receivables increased in the year 2019. Increase in sales and simultaneously increase in receivables says that the credit sales increased during the year 2019. Emphasis should be on cash sales.

Findings and Conclusion

From the above analysis, it is evident that HMCL can improve its working capital management. The overall turnover of gross working capital and net working capital are though impressive but the utilization of different components of working capital needs improvement. Cash management is really efficient at HMCL. The company is maintaining cash at low levels

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which means no idle cash is held by the company. Inventory turnover ratios are also impressive for HMCL. However, the inventory turnover ratio decreased in the year 2019 which should be the matter of concern for HMCL. Receivables management needs attention of the Finance Managers of HMCL. The increase in credit sales means decrease in cash sales. Decrease in receivables turnover ratio reflects an increase in debt collection period. This is evident in the above discussion where the debt collection time touched to 30 days as the highest in the year 2019. This would also have affected the length of operating cycle adversely, as there is delay in receipt of cash. However, it is good that HMCL is maintaining cash and inventory at low levels. Receivables are required to ne managed efficiently by HMCL. The movement of sales and working capital is also in the same direction except for the year 2019 where sales increase but gross working capital decreased. The reason is needed to be found out by HMCL. On the basis of the present study it can be concluded that overall working capital management is efficient at HMCL as the turnover ratios are quite impressive. Considering the components of working capital, cash and inventory are being managed effectively but receivables require corrective measures as the debt collection period of HMCL has considerably increased. Thus, the working capital management can be improved further by HMCL and the length of operating cycle also needs to be monitored to decrease it. A further analysis of liquidity ratios of HMCL is suggested in order to explore the relationship between current assets and current liabilities.

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