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Rating and Financial performance of Selected Indian FMCG Companies: An Exploratory Study

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Abstract

A firm is required to maintain a balance between liquidity and profitability while conducting its day to day operations. Investments in current assets are inevitable to ensure delivery of goods or services to the ultimate customers. Profitability is ability of a company to use its resources to generate revenues in excess of its expenses. In other words, this is a company's capability of generating profits from its operations. A trade-off, then, involves a sacrifice that must be made to obtain a certain product, rather than other products that can be made using the same required resources. It can be defined as the technique of reducing or forgoing one or more desirable outcomes in exchange for increasing or obtaining other desirable outcomes in order to maximize the total return or effectiveness under given circumstances.

The current study analyses the liquidity and profitability tradeoff for select FMCG companies in India. An attempt to understand and assess the qualitative efficiency of liquidity management and liquidity and profitability trade-off for the select FMCG companies was done. The study reveals that with respect to the liquidity ratios all the select five companies had satisfactory results except for HUL that showed very low current ratio for the study period.

Key words: *Liquidity, Profitability, Trade-off, Financial Performance, Liquidity Ratios, Profitability Ratios*

Introduction

A firm is required to maintain a balance between liquidity and profitability while conducting its day to day operations. Investments in current assets are inevitable to ensure delivery of goods or services to the ultimate customers. A proper management of the same could result in the desired impact on either profitability or liquidity. Liquidity is a precondition to ensure that firms are able to meet its short-term obligations.

Profitability can be defined as the final measure of economic success achieved by a company in relation to the capital invested in it. This economic success is determined by the magnitude of the net profit accounting. Profitability is ability of a company to use its resources to generate revenues in excess of its expenses. In other words, this is a company's capability of generating profits from its operations.

The two key aspects of profitability are revenues and expenses. Revenues are the business income. This is the amount of money earned from customers by selling products or providing services. Generating income isn't free, however. Businesses must use their resources in order to produce these products and provide these services. Resources, like cash, are used to pay for expenses like employee payroll, rent, utilities, and other necessities in the production process. Profitability looks at the relationship between the revenues and expenses to see how well a company is performing and the future potential growth a company might have.

Liquidity means how quickly you can get your hands on your cash. In simpler terms, liquidity is to get your money whenever you need it. Liquidity might be your emergency savings account or the cash lying with you that you can access in case of any unforeseen happening or any financial setback. Liquidity also plays an important role as it allows you to seize opportunities. If you have cash and easy access to fund and a great deal comes along, then it's easier for you to cease that opportunity.

The liquidity and profitability goals conflict in most decisions which the finance manager makes. For example, if higher inventories are kept in anticipation of increase in prices of raw materials, profitability goal is approached, but the liquidity of the firm is endangered. Similarly, the firm by following a liberal credit policy may be in a position to push up its sales, but its liquidity decreases. Similarly, there is a direct relationship between higher risk and higher return. A company taking higher risk could endanger its liquidity position. However, if a company has a higher return it will increase its profitability.

In economics, the term trade-off is expressed as opportunity cost, referring to the most preferred alternative given up. A trade-off, then, involves a sacrifice that must be made to obtain a certain product, rather than other products that can be made using the same required resources. It can be defined as the technique of reducing or forgoing one or more desirable outcomes in exchange for increasing or obtaining other desirable outcomes in order to maximize the total return or effectiveness under given circumstances.

The term FMCG refers to those retail goods that are generally replaced or fully used up over a short period of days, weeks, or months, and within one year. These are products that are sold quickly and at relatively low cost. Examples include non-durable goods such as soft drinks, toiletries, and grocery items. Though the absolute profit made on FMCG products is relatively small, they generally sell in large quantities, so the cumulative profit on such products can be substantial. This contrasts with durable goods or major appliances such as kitchen appliances, which are generally replaced over a period of several years.

Review of Literature

Abuzar M.A. Eljell (2004), conducted an empirical study to examine the relationship between profitability and liquidity, as measured by current ratio and cash gap (cash conversion cycle) on a sample of joint stock companies in Saudi Arabia.Regression analysis the study found significant negative relation between the firm's profitability and its liquidity level, as measured by current ratio. The study found that the cash conversion cycle or the cash gap is of more importance as a measure of liquidity than current ratio that affects profitability. The size variable is also found to have significant effect on profitability at the industry level.

Raheman A. and Nasr M. (2007) in their study concluded that working capital management has its effect on liquidity as well on profitability of the firm. In this research, a sample of 94 Pakistani firms listed on Karachi Stock Exchange for a period of 6 years from 1999 – 2004 was collected, and the effect of different variables of working capital management including the average collection period, inventory turnover in days, average payment period, cash conversion cycle and current ratio on the net operating profitability of Pakistani firms was studied. Debt ratio, size of the firm (measured in terms of natural logarithm of sales) and financial assets to total assets ratio were being used as control variables. Pearson's correlation, and regression analysis (Pooled least square and general least square with cross section weight models) are used for analysis. The results show that there is a strong negative relationship between variables of the working capital management and profitability of the firm. It means that as the cash conversion cycle increases it will lead to decreasing profitability of the firm, and managers can create a positive value for the shareholders by reducing the cash conversion cycle to a possible minimum level. They found that there is a significant negative relationship between liquidity and profitability. They also find that there is a positive relationship between size of the firm and its

profitability. There is also a significant negative relationship between debt used by the firm and its profitability.

Dash M. and Ravipati R. (2009), this paper proposes a goal programming model for working capital management. Goal programming is necessary to model the working capital decision, as a balance has to be achieved between the conflicting objectives of liquidity and profitability. The model determines, for given working capital turnover and fixed assets turnover ratios, how funds should be maintained between working capital/current assets and fixed assets to achieve targeted levels of liquidity and profitability, whilst minimizing the opportunity cost/loss of excess liquidity.

Bhunia A. and Khan I. U. (2011), found that liquidity management is of crucial importance in financial management decision. The optimal of liquidity management is could be achieve by company that manage the trade-off between profitability and liquidity management. The paper analyses the association between the liquidity management and profitability of 230 Indian private sector steel companies obtained from CMIE database. Liquidity management indicators and profitability indicator over the period from 2002 to 2010 are modeled as a linear regression system in multiple correlation and regression analysis. Evidence of petite association between those variables is found. A descriptive statistics discloses that liquidity and solvency position is very satisfactory and relatively efficient liquidity management is found. Multiple regression tests confirm a lower degree of association between the liquidity management and profitability.

Rationale of the Study

The current study aims to understand and assess the qualitative efficiency of liquidity management and liquidity and profitability trade-off in Selected FMCG Companies. The study will help us to understand the relationship between liquidity and profitability and also to understand its effect on the efficiency of the companies.

Objective's of the Study

Measure efficiency of liquidity management by using ratio analysis.
Compare the liquidity position of the select FMCG companies.
Study the trade-off between liquidity and profitability.

Methodology

The Study: The present research is descriptive in nature and aims to understand the liquidity, profitability and trade-off for select Indian FMCG companies.

The Sample: The sample consists of annual data of select five FMCG companies namely HUL, ITC, United Spirits Ltd., Colgate Palmolive and Dabur. The data was collected for the period of ten years i.e. from March 2011 – March 2015

Tools for Data Collection: Secondary data for the present study was collected from the relevant official websites of NSE, HUL, ITC, Colgate, United Spirits Ltd., Dabur and money control.com, etc

Tools for Data Analysis: The collected data was analysed with the help of ratio analysis, liquidity and profitability ratios, Motaal's comprehensive test.

Result & Analysis

The collected data was analysed and liquidity ratio, profitability ratio, activity ratios were calculated to assess the performance of the select FMCG companies. Generally, a current ratio of 2:1 is considered to be acceptable. The higher the current ratio is, the more capable the company is to pay its obligations. A high ratio indicates "safe" liquidity but in this company current ratio is continuously decreasing. Quick Ratio is an indicator of company's short-term liquidity. It measures the ability to use its quick assets (cash and cash equivalents, marketable securities and accounts receivable) to pay its current liabilities. Ideally, quick ratio should be 1:1. Gross profit ratio (GP ratio) is the ratio of gross profit to net sales expressed as a percentage. It expresses the relationship between gross profit and sales. As higher the Gross Profit Ratio

betters the results. Net Profit Ratio is the ratio of net income and net sales and is expressed in percentage i.e. it expresses the relationship between net income and net sales.

Dabur

Table.1

Liquidity Ratios					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Current	1.25	1.73	1.50	1.48	1.51
Quick	0.81	1.24	1.07	0.99	1.01
Profitability Ratio					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Gross Profit	16.06	15.84	15.66	15.72	17.91
Net Profit	14.04	13.8	13.58	12.32	14.36
Operating Profit	17.27	16.95	17.34	17.47	19.06
Solvency					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Debt-to-equity	0.06	0.02	0.15	0.21	0.23
Net Worth	32.64	35.33	37.05	35.56	42.81
Interest coverage	102.16	45.55	41.74	45.82	56.06
Activity Ratio					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Stock turnover	10	8.72	8.7	7.18	8.65
Debtors Turnover	16.41	16.84	18.14	17.62	19.67

In 2014 Dabur company has good current ratio but in remaining 4 years the liquidity of company is continuously decreasing which indicates the poor working capital management of company. Here the company liquidity position is very good. Similarly in 2014, company has very good quick ratio but in other 4 years the liquidity of company is continuously decreasing. This indicates that in future company will face difficulty in payment of short term liabilities. This company shows very good G.P. ratios in all years. Stock **Turnover Ratio** is one of the efficiency ratios and measures the number of times, on average; the inventory is sold and replaced during the fiscal year. A high inventory turnover ratio can indicate better liquidity. All above three ratios show that company has a sound profitability in the market which will help the company in constant growth and increasing in market share.

Debt-equity ratio is a ratio which expresses the relationship between debt and equity. This ratio explains how far owned funds are sufficient to pay outside liabilities. The Debt-Equity Ratio indicates the extent to which debt financing has been used in the business. In this case less debt-equity ratio indicate that company is not so much rely on debt (long-term loans, liabilities) that means company's capital structure consist of more proportion of equity capital.

Interest coverage ratio (ICR) is a measure of a company's ability to meet its interest payments The interest coverage ratio is a measure of the number of times a company could make the interest payments on its debt with its EBIT. It determines how easily a company can pay interest expenses on outstanding debt. Here the ratio is increasing throughout the 5 year, which represent sound liquidity of company but usually unhealthy.

Debtors /Receivables turnover ratio measures **company's efficiency in collecting its sales on credit** and collection policies. This ratio takes in consideration only the credit sales. Here the

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company Debtors turnover ratio is continuously increasing. It means that company credit and collection of accounts receivable are efficient. (Refer Table 1).

ITC

Table.2

Liquidity Ratios					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Current	1.45	1.25	1.22	1.12	1.09
Quick	0.87	0.68	0.66	0.56	0.53
Profitability Ratios					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Gross Profit	34.27	34.76	32.88	32.37	31.48
Net Profit	26.31	26.43	24.8	24.47	23.24
Operating Profit	36.9	37.47	35.54	35.15	34.54
Solvency Ratio					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Debt-to-equity	0.00	0.00	0.00	0.00	0.01
Net Worth	31.31	33.51	33.36	32.88	31.36
Interest coverage	244.77	4292.22	124.56	115.19	107.29
Activity Ratio					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Stock turnover	6.43	4.52	4.53	4.47	5.85
Debtors Turnover	18.78	19.97	27.82	26.91	24.61

The company shows decrease in the current ratio indicates that there has been deterioration in the liquidity position of the firm. A quick ratio more than 1:1 may indicate ITC Company relies too much quick assets to pay its short-term liabilities. This company shows very good G.P. ratios in all years. Above table (2) indicating the high profitability of ITC in the 5 year period.in year 2015 company showed tremendous growth in stock turnover ratio. Debtor turnover is decreasing in year 2014-15 which indicate that company believes in the cash sales rather credit sales.

Colgate Palmolive

Table 3

Liquidity					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Current	0.80	0.85	1.07	1.09	1.12
Quick	0.53	0.57	0.82	0.76	0.83
Profitability					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Gross Profit	21.48	19.96	22.33	23.36	24.31
Net Profit	14.03	15.08	15.70	16.6	17.62
Operating Profit	----	----	----	21.52	22.77
Solvency					

Ratio	Mar'15	Mar'14	Mar'13	Mar'12	Mar'11
Debt-to-equity					
Return On Net Worth	72.56	79.26	101.46	102.33	103.15
Interest coverage	----	----	----	389.32	158.91
Activity Ratio					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Stock turnover	15.79	15.85	17.07	12.37	14.87
Debtors Turnover	64.03	52.65	37.56	41.28	86.64

In case of this company current ratio is continuously decreasing which shows its poor liquidity.In case of Colgate the quick ratio is less than 1 or we can say that almost half, which indicate that company does not sufficient fund to pay off their current liabilities. This company shows very good G.P. ratios in all years.**Net Profit Ratio** represents the sound profitability of the company. Higher the operating ratio, the less favourable in 2011.operating ratio was good and and it is nil in 2015. **In the year 2013 company has Colgate has excellent stock turnover ratio.** The company has very good debtor turnover ratios which represent that the the company is enjoying to sell their goods on credit. (Refer Table 3).

Hindustan Unilever Limited

Table.4

Liquidity Ratios					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Current	0.75	0.74	0.76	0.83	0.86
Quick	0.47	0.44	0.45	0.46	0.46
Profitability Ratios					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Gross Profit	15.97	15.04	14.59	13.89	12.45
Net Profit	14	13.8	14.7	12.16	11.68
Operating Profit	`24.07	20.69	18.51	15.23	12.4
Solvency Ratios					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Debt-to-equity	----	----	----	----	----
Return on Net Worth	115.87	118.04	142.01	76.62	86.72
Interest coverage	329.37	134.21	173.94	2702.74	11376.83
Activity Ratios					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Stock turnover	12.57	10.76	10.8	9.21	7.34
Debtors Turnover	38.52	33.96	34.13	27.27	24.34

In case of this company current ratio is continuously decreasing which shows its poor liquidity. This company shows very good G.P. ratios in all years. The Net Profit ratio is increasing in all years except year 2014.From year 2011 the Stock Turnover Ratio is continuously increasing to

the year 2015, which indicates that company has a very good growth in their revenue. Similarly in **Debtor Turnover Ratio** company having excellent growth in last 5 years (2011-2015) which representing loyalty of customers towards the company. (Refer Table 4).

United Spirit

For United Spirits all five years have approximately 3 or more than 3 times current assets of current liabilities and there is a major proportion in current assets. This company shows very good G.P. ratios in all years. The company Debtors turnover ratio i s continuously increasing. It means that company credit and collection of accounts receivable are efficient. (Refer Table 5).

Table.5

Liquidity					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Current	0.96	1.14	1.3	1.41	2.08
Quick	2.93	3	2.69	2.81	4.39
Profitability Ratios					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Gross Profit	4.67	-2.84	12.07	11.77	14.57
Net Profit	-24.3	-59.91	3.73	4.54	6.03
Operating Profit	13.25	5.55	14.34	5.19	12.53
Solvency Ratios					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Debt-to-equity	2.64	1.22	0.53	0.59	0.71
Net Worth	-100.74	- 133.77	5.01	5.83	7.55
Interest coverage	0.9	-0.15	1.77	1.93	2.37
Activity Ratios					
Ratio	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**
Stock turnover	13.25	5.55	14.34	5.19	12.53
Debtors Turnover	4.65	4.89	5.63	6.73	6.71

Motaal's comprehensive test

Further, motaal's comprehensive test was applied for which rating of ratios was done for the select five companies and then further a comprehensive rating for the overall performance was done to understand the overall best performer company in FMCG Sector

Rating On The Basis Of Overall Rating

Table.5

Company Name Year	**Mar'15**	**Mar'14**	**Mar'13**	**Mar'12**	**Mar'11**	**Total**
Colgate palmolive	4	3	3	2	2	14 (iii)
Hindustan unilever Ltd	1	2	1	1	1	6 (i)
Dabur	3	4	4	4	4	19 (iv)
United spirit	5	5	5	5	5	25 (v)
ITC	2	1	1	3	3	10 (ii)

As of the above table 5 each of the considered companies has scored certain rankings and according to the phenomenon of the MOTALL'S Comprehensive Test, the organization that has scored the least is the most efficient and has sound profitability and liquidity. In this case, HUL has scored the least ranking total and hence is considered the best among the sample taken. Consecutively, ITC has scored the second least ranking total which states that it is also has an efficient management but just lagging in either profitability or liquidity than that of HUL. Out of the remaining three companies, United Spirits has the highest ranking total which suggests that it is lacking in profitability as well as liquidity and needs to improve in order to provide a competitive edge to the rivals. Last but not least Colgate Palmolive and Dabur has scored third least and fourth least ranking total respectively which tells that they both have to improve them to be in the competition.

Conclusion

The present study was an attempt to understand and assess the qualitative efficiency of liquidity management and liquidity and profitability trade-off for the select FMCG companies. The study reveals that with respect to the liquidity ratios all the select five companies had satisfactory results except for HUL that showed very low current ratio for the year 2015. The current ratio of all the five companies is improving except for HUL whose current ratio is reduced for the year 2015 as compared to in the year 2011-13.

In case of Profitability Ratios, As higher the Gross Profit Ratio better the results so, among all the five companies the Gross Profit Ratio was better for ITC in the year 2015 while it was worst in the year 2011 for HUL . The current Net Profit Ratio of ITC and Colgate- Palmolive is increasing. For return on net worth the HUL had the highest return, followed by HUL and ITC and united spirits had the least returns. The Motaal's comprehensive test revealed that HUL and ITC in the years 2011-15 marked the most sound liquidity position.

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