www.rspsciencehub.com Volume 03 Issue 06S June 2021

INTERNATIONAL RESEARCH JOURNAL ON ADVANCED SCIENCE HUB

e-ISSN : 2582 - 4376
Open Access

RSP SCIENCE HUB
(The Hub of Research Ideas)
Available online at www.rspsciencehub.com

Special Issue of First International Conference on Management, Science and Technology (ICMST 2021)

Analysis on Liquidity and Profitability Position of Food and Beverage Product Industry

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Abstract
In the corporate world there has been a burning issue in the trade-off between liquidity and profitability position of the organisation. In the management there is a need to trade-off between liquidity and profitability as it helps to maximise the shareholder's wealth. In the growth and survival of the business liquidity and profitability are very important issues. The main aim of the study is to know the relationship between liquidity and profitability of NESTLE India limited. The study covered a period of five years from 2015-2019. To analyse the relationship between liquidity and profitability the study has used liquidity and profitability as financial tools and Karl Pearson, correlation of co-efficient as statistical tools. It is found that there is a negative relationship between liquidity and profitability of the firm.
Keywords: Liquidity, Financial tools, Correlation, Profitability.

1. Introduction

In a firm, Liquidity is the ability to pay its short-term obligation for the continuous operation. It is not only measured by the cash balances but also by all kind of assets which can be converted into cash within one year without losing their value. Liquidity can be measured primarily by current ratio and net working capital. It also measures the quality of assets. Liquidity is represented by net working capital of the company i.e. excess of current assets over current liabilities. It plays a dominant role in the successful functioning of an organisation. In a company, the main ability of Profitability is to use its resources to generate revenues in excess of its expenses. It is used to analyse the financial statements and to know the performance of the company as a whole. The main key aspects of profitability are Revenues and Expenses. Revenues are defined as the business income and Expenses are defined as the cash used to pay for employment payroll, rent, utilities and other necessities in the production process. Profitability has secondary importance and it measures the economic success of the firm irrespective to cash flow.

Liquidity is required for the short-term survival and Profitability is required for the long-term survival of the firm. Liquidity and profitability are inversely related. To ensure smooth running of business there must be a proper balance between liquidity and profitability. Therefore, it proves that both are important for the survival of the short and long term of the firm. [1-4].

2. Research Methodology

2.1 Objectives of the study

To study the relationship between the Liquidity and Profitability of the selected company.

2.2 Need for the study

The need of this study is to analyse the relationship between liquidity and profitability of NESTLE India limited. To survive in the corporate world liquidity and profitability of a business must be in a good position. It helps to run a business more efficiently and effectively.

2.2.1 Secondary data

The study is based on the secondary data. The data has been collected from the annual reports of the company for the period of five years and the relevant information has been collected from the other publications.

2.2.2 Period of the study

The study period is for the past five financial years, i.e., from FY 2015 to FY 2019. The financial year of Nestle India Limited was based on the calendar year (January to December).

2.3 Scope of the study

The main focus of the study is to know the relationship between liquidity and profitability of NESTLE India limited and its position with the help of selective accounting ratios of the company. The study deals with the overall performance of the management and to know the impact of liquidity and profitability position of the company. The scope of the study is restricted for five years only.[5-8].

2.4 Limitations of the study

- The study is entirely based on the secondary data taken from the published annual report of NESTLE India limited.
- The study has been calculated only with limited ratios based on the financial information.
- The research will reflect only a partial view of the company as the whole company is not completely generalized.

2.5 Ratio analysis

Ratio analysis is a computable method, which is used to analyse a company's profitability, liquidity and operational efficiency from its financial statements. It compares the items given in the profit and loss account or balance sheet of a company. Ratio analysis helps a firm in the preparation of budget by analysing the past trends of that firm. It also helps to indicate the liquidity and long-term solvency position of the firm.

2.6 Liquidity ratio

Liquidity ratios are used to ascertain the firm's ability to meet its short-term debt obligations. It indicates whether a company's current assets are sufficient to meet its obligations when they become due. Liquidity ratio comes under financial ratios. Two main ratios calculated under liquidity ratio are:

- ➢ Current Ratio
- ➢ Quick or Acid-test Ratio

2.7 Current Ratio

Current ratio is used to measure a firm's ability to meet its short-term obligations with the use of current assets.

$$\textbf{Current ratio} = \frac{\textbf{Current assets}}{\textbf{Current liabilities}}$$

Quick Ratio or Acid-test Ratio

Quick ratio helps to measure the short-term liquidity position of a company. It is also called as acid-test ratio.

$$\textbf{Quick ratio} = \frac{\textbf{Current assets – Inventories}}{\textbf{Current liabilities}}$$

The table 1 shows different ratios measuring the performance of working capital management in Nestle India. The table 1 shows the short-term solvency or liquidity ratios of Nestle India Limited. The Current ratio and Quick ratio of the firm are fluctuating between the financial years 2015-2019. Therefore, the percentage of Working capital to current asset, Inventory to current asset and Quick assets to current asset are also fluctuating during the study period. Hence, there is no constant fall or rise in the ratios of firm.[9-12].

2.8 Profitability ratio

Profitability ratios are those which asses a firm to earn more profits from its sales or operations, shareholder's equity and balance sheet assets. This ratio denotes how a company effectively generates its profits.

Some types of profitability ratio are,

- ➢ Operating profit margin
- ➢ Gross profit margin
- ➢ Net profit margin
- ➢ Return On Capital Employed (ROCE)

Table.2 shows the profitability analysis of Nestle India Limited for the study period (2015-19). The percentage of operating profit margin, gross profit margin, net profit margin and ROCE are calculated for the study. Operating profit margin of Nestle ltd. has been fluctuating between the years of 2015-2019. Gross profit margin, Net profit margin and ROCE of the firm are noted to be increasing constantly during the study period.

The below table shows the current ratio and ROCE

(Return On Capital Employed) for the study period FY 2015 – FY 2019. This has been extracted to find the relationship between the liquidity and profitability of the firm. Here, current ratio represents the liquidity and ROCE represents the profitability. Current ratio of the firm was fluctuating between the years 2015-2019. And, the ROCE of the firm was steadily increasing during the period. The value of Pearson's Correlation r = -.137 which lies between (-1 to 0). The acceptance of null hypothesis is proved to be false, it shows that there is a relationship between the liquidity and profitability. From this analysis, the relation between current ratio and ROCE are negatively correlated. It proves that there is a negative relationship between the liquidity and profitability of the firm.

Table 1: Short term Solvency ratios

Year	Current assets (1)	Current liabilities (2)	Working capital (1-2=3)	Inventory (4)	Quick assets (1-4=5)	Current ratio	Quick ratio	Working capital to current assets (%)	Inventory to current assets (%)	Quick assets to current assets (%)
2015	2479.61	1475.73	1003.88	820.81	1658.80	1.68	1.12	40.49	33.10	66.90
2016	3278.99	1632.70	1646.29	943.18	2335.81	2.01	1.43	50.21	28.76	71.24
2017	3937.39	1492.71	2444.68	902.47	3034.92	2.64	2.03	62.09	22.92	77.08
2018	4736.95	1854.95	2882.00	965.55	3771.40	2.55	2.03	60.84	20.38	79.62
2019	3817.17	2147.51	1669.66	1283.07	2534.10	1.77	1.18	43.74	33.61	66.39

Table 2: Profitability analysis

	2015	2016	2017	2018	2019
Operating Profit Margin (%)	19.02	18.72	20.95	23.18	23.16
Gross Profit Margin (%)	14.55	16.11	19.97	25.18	27.64
Net Profit Margin (%)	6.88	10.04	12.24	14.22	15.92
ROCE (%)	28.61	29.13	32.90	40.76	56.91

Table 3: Current ratio and ROCE of Nestle

YEAR	CURRENT RATIO	ROCE
2015	1.68	28.61
2016	2.01	29.13
2017	2.64	32.90
2018	2.55	40.76
2019	1.77	56.91

Table 4: Relationship between Current ratio and ROCE (Karl Pearson's co-efficient of correlation)

		Current ratio	Roce
Current ratio	Pearson Correlation	1	**-.137**
	Sign. (2-tailed)		.826
	N	5	5
Roce	Pearson Correlation	**-.137**	1
	Sign. (2-tailed)	.826	
	N	5	5

2.9 Hypothesis Testing:

H0: There is no relationship between the liquidity and the profitability.

H1: There is a relationship between the liquidity and the profitability.

3. Findings

- The relationship between liquidity and profitability are found to be negative as the correlation value lies between -1 to 0, therefore r = -0.137. For this analysis, current ratio is taken to represent the liquidity and ROCE represents the profitability.
- By using correlation, we prove that there is a negative relationship between the liquidity and profitability of the firm. Hence, the current ratio and ROCE are negatively correlated.

4. Suggestions

- It is suggested that the company has to focus on its liquidity position to meet its day to day operations effectively in the forthcoming year.
- The study clearly defines that there is a negative relationship between liquidity and profitability of the company during the period of the study, so the company has to make a proper balance between liquidity and profitability by maintaining some trade-off between them.

Conclusion

The study has come to a conclusion that the position of liquidity and profitability of Nestle India Limited is unsatisfactory during the period of the study as it indicates a negative relationship between them. It is found that the company has to utilize its current assets effectively to meet its current liability in the day to day financial operations. It is clear that the company has to concentrate more on its liquidity position as the shortage of working capital leads to lack of liquidity.

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