Liquidity Management of Neyveli Lignite corporation Limited - Empirical Study

*** Ms. N. Velmathi * * Dr. R. Ganesan**

ABSTRACT

Current assets management that affects a firm's liquidity is yet another important finance function, in addition to the management of long-term assets. Current assets should be managed efficiently for safeguarding the firm against the dangers of liquidity and insolvency. Investment in current assets affects the firm's profitability, liquidity and risk. A conflict exists between profitability and liquidity which managing current assets. If the firm does not invest sufficient funds in currents, it may become illiquid. But it would lose profitability as idle current assets would not earn anything. Thus, a proper trade-off must be achieved between profitability and liquidity. Each and every company has to estimate needs for current assets and make sure that funds would be made available when needed.

It would thus be clear that financial decisions directly influence production, marketing and other functions of the firm. This, in consequence, finance functions may affect the size, growth, profitability and risk of the firm, and ultimate, the value of the firm.

Introduction

Liquidity is an important feature of any organization. Liquidity is the lubricating agent that facilitates a frictionless smooth functioning of all organization. In general, the term liquidity refers to the easy convertibility of assets into cash.

Liquidity is an asset is very precisely defined by Keynes that an asset is more liquid than another, Mf it is more certainly realizable at short notice without loss' (1930). The variations in the degree of liquidity affect the price discovery process and efficiency of the market. If the price difference is less, then it indicates more liquid/the reverse position is less liquid.

The importance of adequate liquidity in the sense

*Assistant Professor, MBA, Muthayammal Engineering College, Rasipuram
**Principal, Nehru Institute of Information Technology and Management, Coimbatore

of the ability of a firm to meet current/short-term obligations when they become due for payment can hardly be overstressed. In fact, liquidity is a prerequisite for the very survival of a firm. The short-term creditors of the firm are interested in the short-term solvency or liquidity of a firm. But liquidity implies, from the viewpoint of utilization of the funds of the firm, which funds are idle or they earn very little. A proper balance between the two contradictory requirements, that is, liquidity and profitability, is required for efficient financial management. Thus, Neyveli Lignite corporation ltd is also required to analyze its liquidity position.

Profile of Neyveli Lignite Corporation Limited

India has to depend on coal and lignite for most of its commercial energy requirement, for many years to come. Tamil Nadu has been blessed with an abundant supply of lignite, almost 80% of the country's total reserves. Since this region is far away from the coal belt, it is essential that lignite reserves are effectively used to meet energy needs in the south.

Neyveli Lignite Corporation was formed in 1956 by late Pandit Jawaharlal Nehru, the first Prime Minister of India with the objective of optimum utilization of lignite for the generation of power and consists of two open cast mines, with a capacity of 6.5 million tones and 10.5 million tones of lignite per annum respectively. Neyveli Lignite Corporation (NLC) is situated in the south of India in Tamil Nadu, NLC mines 11MT of lignite annually, of which 9.5 MT are used for electricity generation.

It has grown manifold and has significantly contributed to the industrial and economic growth of Tamil Nadu. Neyveli is one of the many "Temples of Modern India" that Pandit gave our country. In 2006 NLC celebrated the golden jubilee. In the same year NLC was expanding the mine capacity and also the capacity of the Thermal Power Station. This involves a massive investment of Rs.4,200 crore. This new investment will benefit the people of Tamil Nadu and of this entire region. The NLC has won the FICCI (Federation of Indian Chambers of Commerce and Industry) award for its innovative approaches to foster harmonious industrial relations through bipartite mechanisms, reducing conflicts and man days losses and promoting employees welfare and development avenues, contributing to higher motivation, morale and productivity improvement

NLC has bagged more than 35 awards so far for its Performance, Productivity, Better Management, Safety awards, Best Public Sector award, Fly ash utilization award, State award for Industrial Relations etc

Statement of the problem

Power is a crucial infrastructure for socio economic development. Supply of quality power at reasonable rates will make it affordable to the rural population and make our industries competitive. Therefore, the Common Minimum Programme of the United Progressive Alliance attaches the highest priority to the development and expansion of basic infrastructure including power. Our Government is making all out efforts to improve generation, transmission and distribution of electricity so that each and every household in the country will have access to it. This is a national priority.

Neyveli Lignite Corporation is one public sector company which is running in profits for more than two decades. Hence the researcher needs to find out its liquidity position. and what are major components occupying in the current assets.

Objectives of the study

The following are the objectives of the present study.

1. To find out the mix of current assets of the NLC Ltd
2. To examine and evaluate the liquidity position of NLC Ltd.
3. To offer some valid suggestions for improvement of the liquidity position of NLC Ltd.

Period of the study

The period of the study selected only nine years from 1998-99 to 2006-07.

Methodology

The study is analytical in nature. The data for the study collected from secondary sources only. Most the data collected from published annual reports of the company, journals, websites, books etc. Editing, classification and tabulation of the financial data, which will be collected from the above-mentioned sources, will be done as per the requirements of the study.

For assessing liquidity position of the NLC Ltd. Company, ratio analysis, Mean, Standard deviation, Co-efficient of variance is used.

Limitation of the study

The data used in this study have been taken only from Annual reports of the NLC Ltd.

Liquidity position of NLC Ltd.

It is evident from table No.1 that the size of current assets had increased from Rs.2591.97crores in March 99 to Rs.5398.09 crores in March 07 and current liabilities also increased form Rs.601.43 crores in March 99 to Rs.1653.28 crores in March 07. The average of current assets and current liabilities are Rs.3178.28 and Rs.963.74 crores with a standard deviation of Rs.967.44 crores and Rs.312.48 crores. The co-efficient of variance of current assets and current liabilities are 30% and 32% respectively. Hence the co-efficient of variance of current assets are less than current liabilities, which reflects current assets are more consistent than current liabilities.

The total of quick assets increased from Rs.2171.75 in Mar 99 and Rs.4942.6 crores in March 07. The net working capital of Rs.1990.54 crores in March 99 has increased from Rs.3744.81crores in March 07. Thus, it reveals company is maintaining large amount as working capital to carry out their day-to-day operations. The liquidity position of NLC Ltd. is also very good.

The average amount of quick assets and net working capital are Rs.2781.79 crores and RS.2214.53 crores. Both quick assets and net working capital is having 35% as a co-efficient of variance. This is more than current assets. Thus, it indicates that the liquidity position of the company is satisfactory.

Measurement of liquidity

The measurement of liquidity helps to indicate the level of solvency and financial flexibility of the firm. In order to ensure a desire level of solvency and provide to enough financial flexibility to attain the strategic goals of the enterprise, the following important liquidity ratios are used to measure the liquidity of a concern.

Liquidity ratios of NLC Ltd.

The liquidity ratio is also termed as 'working capital management'. An enterprise must have adequate working capital to run its day-to-day operations. Inadequacy of working capital may bring the entire business operation to a grinding halt because of inability of the enterprise to pay for wages, materials and other regular expenses. The important liquidity ratios are as follows:-

i) Current ratio

ii) Quick ratio

iii) Cash ratio

iv) Net working capital ratio

Current Ratio

The current ratio is the total current assets to total current liabilities. The current ratio of a firm measures its short-term solvency ie) its ability to meet short-term obligations. As a measure of short-term liquidity, it indicates the rupees of current assets (Cash balance and its potential source of cash) available for each rupees available per rupee of current liability, the more is the firm's ability to meet current obligations and the greater is the safety of funds of short-term creditors.

Conventionally, a current ratio of 2:1 is considered satisfactory. The logic underlying the conventional rule is that even with a drop-out of 50% in th

e value of current assets, a firm can meet its obligations, that is a 50% margin of safety is assumed to be sufficient to ward off the wardoff the worst of situations.

Quick Ratio/ Acid Test ratio

The Acid test ratio is the ratio between quick current assets and current liabilities. A rupee of cash is considered equivalent to a rupee of inventory/receivables. A rupee of cash is more readily available (ie. More liquid) to meet current obligations than a rupee of, say, inventory. This impairs the usefulness of the current ratio. Acid test ratio is a rigorous measure of a firm's ability to convert its current assets quickly into cash in order to meet its current liability. Thus, it is a measure of quick/ acid liquidity.

Generally, a quick ratio of 1:1 is considered satisfactory as a firm can easily meet all current claims.

Cash ratio

Cash ratio is the most rigorous and conservative test of a firm's liquidity position. Further, it is suggested that it would be useful, for the management, if the liquidity measure also takes into account 'reserve borrowing power' as the firm's real debt paying ability depends not only on cash resources available with it but also on its capacity to borrow from the market at short notice.

Ratio of inventory to working capital

In order to ascertain that there is no overstocking, the ratio of inventory to working capital should be calculated. Working capital is the excess of current assets and current liabilities. Increase in volume in volume of sales requires in size of inventory, but from a sound financial point of view, inventory should not exceed amount of working capital. The desirable ratio is 1:1.

It is observed from the table No.4 that the current ratio of NLC Ltd varied between 2.29 and 5.01 during the 1998-99 to 2006-07. The average ratio is 3.42%. the ratio is more than the rule of thumb of 2:1. Hence the liquidity position of the NLC Ltd is very good. The quick ratio of NLC Ltd is fluctuating between 1.90 and 4.51 during the study period. The average ratio is 2.97%. It depicts that the ratio is more than the standard norms 1:1, which means that the NLC Ltd is maintaining its assets properly and able to solve its short-term obligations.

The cash ratio of the NLC Ltd is 0.35 in 1998-99 and 2.57% in March 07. The average ratio is 1.26. thus, the ratio is more than the standard norms ie).5:1 which means that, the first 5 years current liabilities are more than the liquid assets so that the company is not able to pay its dues in prompt time. But the last 4 years NLC Ltd cash ratio is more than the current liability, so that the company is able to settle it's outstanding in prompt time.

The ratio of inventory to working capital of the NLC Ltd. is 0.21in 1998-99 and 0.12 in 2006-07.

The average ratio is 0.20. In this study period the NLC is maintaining less amount inventory compare than the working capital. Hence the NLC Ltd.is keeping optimum level of inventory.

Conclusion

Liquidity Management plays a crucial role in success of a business firm. Surveys indicate the largest part of a financial managers time is devoted to the management of current liabilities as any big discrepancy between current liabilities and current assets is a danger signal for the worsening liquidity poison of the firm. From the view of the conventional standards norms of current ratio, quick ratio, cash ratio and ration of inventory to working capital are good. The Neyveli Lignite Corporation limited is maintaining current is in optimum level. Hence the liquidity position of the Neyveli Lignite Corporation limited is very good. In order to maintain the same level, the liquidity position of Neyveli Lignite Corporation limited has to utilize its assets in effective manner in the future period also.

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Table No.1 Showing Current Assets, Current Liabilities and Net working capital of Neyveli Lignite corporation Limited

Years	**1998-99**	**1999-2000**	**2000-2001**	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**2006-07**
Current Assets									
Inventories	420.22	467.64	456.48	398.1	351.42	305.55	355.06	358.45	455.49
Sundry Debtors	790.31	334.23	1276.07	1426.47	2448.99	583.71	705.65	168.34	89.41
Cash and Bank Balances	208.71	359.45	402.62	373.68	275.85	1208.15	1968.69	2549.12	4253.06
Other current Assets	123.27	101.46	80.41	49.69	58.2	290.66	285.99	202.85	232.52
Loans and Advances	1049.46	923.56	456.65	356.44	247.81	242.71	206.69	337.64	367.61
Total(A)	**2591.97**	**2186.34**	**2672.23**	**2604.38**	**3382.27**	**2630.78**	**3522.08**	**3616.4**	**5398.09**
Current Liabilities									
Current Liabilities	458.57	662.11	866.77	511.43	501.12	573.83	510.55	593.82	1236.66
Provisions	142.86	115.25	298.22	299.47	456.25	507.73	394.37	128.09	416.62
Total(B)	**601.43**	**777.36**	**1164.99**	**810.9**	**957.37**	**1081.56**	**904.92**	**721.91**	**1653.28**
Net working capital	1990.54	1408.98	1507.24	1793.48	2424.9	1549.22	2617.16	2894.49	3744.81

Table No.2 Showing Liquidity position of the Neyveli Lignite corporation Limited

Years	Current Assets	Current Liabilities	Quick Assets	Net working capital
1998-99	2591.97	601.43	2171.75	1990.54
1999-2000	2186.34	777.36	1718.7	1408.98
2000-2001	2672.23	1164.99	2215.75	1507.24
2001-02	2604.38	810.9	2206.28	1793.48
2002-03	3382.27	957.37	3030.85	2424.9
2003-04	2630.78	1081.56	2325.23	1549.22
2004-05	3522.08	904.92	3167.02	2617.16
2005-06	3616.4	721.91	3257.95	2894.49
2006-07	5398.09	1653.28	4942.6	3744.81
SUM	28604.54	8673.72	25036.13	19930.82
Mean	3178.28	963.75	2781.79	2214.54
Range	2186.34 - 5398.09	601.43 -1653.28	1718.7 - 4942.6	1408.98 -3744.81
Std. Deviation	967.74	312.49	966.22	776.99
C.V	0.30	0.32	0.35	0.35

Table No.3 showing Liquidity ratios of the Neyveli Lignite corporation Limited

Years	Current Ratio	Quick Ratio	Cash Ratio	Current Assets	Inventory to turnover ratio
1998-99	4.31	3.61	0.35	2591.97	0.21
1999-2000	2.81	2.21	0.46	2186.34	0.33
2000-2001	2.29	1.90	0.35	2672.23	0.30
2001-02	3.21	2.72	0.46	2604.38	0.22
2002-03	3.53	3.17	0.29	3382.27	0.14
2003-04	2.43	2.15	1.12	2630.78	0.20
2004-05	3.89	3.50	2.18	3522.08	0.14
2005-06	5.01	4.51	3.53	3616.4	0.12
2006-07	3.27	2.99	2.57	5398.09	0.12
SUM	30.76	26.76	11.30	28604.54	1.79
Mean	3.42	2.97	1.26	3178.28	0.20