LIQUIDITY – PROFITABILITY RELATIONSHIP: A STUDY OF TEN LEADING FMCG COMPANIES IN INDIA

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ABSTRACT

The study sought to find out the relationship between the liquidity and the profitability of ten leading FMCG companies in India. The study was descriptive in nature. Document analysis was the main research procedure adopted to collect secondary data for the study. The financial reports of the ten leading FMCG companies were studied and relevant liquidity and profitability ratios were computed. Liquidity and Profitability are the most noticeable issues in the corporate finance literature. Liquidity refers to the financial ability of the firm to meet the short term obligations as and when they arise. Profitability is the profit earning capacity which is a crucial factor contributing for the survival of the firms. The ultimate goal for any firm is to maximize profitability. However, finance literature says too much attention on profitability may lead the firm into a pitfall by diluting the liquidity position of the company. The research paper mainly focuses on analyses of relationship between liquidity and profitability of selected FMCG companies in India during period of 2005-06 to 2014-15; the tools used for analysis are Spearman’s Rank correlation and t-tests. It was found that both the liquidity and the profitability of the selected FMCG companies were hovering. Again, it was also found that there was a very strong positive relationship between the liquidity and the profitability of the selected FMCG companies in India.

Key words: Liquidity, Profitability, Spearman’s Rank correlation, FMCG companies

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1. INTRODUCTION
The market size of FMCG in India is estimated to grow from US$ 30 billion in 2011 to US$ 74 billion in 2018. Food products is the leading segment, accounting for 43 per cent of the overall market. Personal care (22 per cent) and fabric care (12 per cent) come next in terms of market share. Growing awareness, easier access, and changing lifestyles have been the key growth drivers for the sector. FMCG Industry is characterized by a well-established distribution network, low operating cost, lower per capital consumption and intense competition between the organized and unorganized segments. The realization of the customer’s growing interests and the need to meet changing lifestyle required the FMCG producing companies to formulate customer-centric strategies. These changes have positive impact, leading to the rapid growth in the FMCG industry. The FMCG industry plays a significant role in shaping a country’s economy and development. This sector can drive growth, enhance quality of life, create jobs and support penetration of technology. The FMCG sector has grown at an annual average of about 11 per cent over the last decade. The overall FMCG market is expected to increase at (CAGR) of 14.7 per cent to touch US$ 110.4 billion during 2012-2020, with the rural FMCG market anticipated to increase at a CAGR of 17.7 per cent to reach US$ 100 billion during 2012-2025. Top 10 FMCG companies in India are HUL, Colgate, ITC, Nestle, Britannia, Marico, P&G, Dabur, Godrej and Emami.

With this background, the present study aims at analyzing relationship between the liquidity and the profitability of 10 leading FMCG companies in India.

PROFITABILITY
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.

To achieve an appropriate return over the amount of risk accepted by the shareholders, is the main objective of companies operating in capitalist economies. After all, profit is the propulsive element of any investments in different projects. The assessment of profitability is usually done through the ROI (Return on Investment = (Net Profit/Sales) X (Sales/Capital Employed) which is the ultimate measure of economic success.

LIQUIDITY
Accounting liquidity is the company’s capacity to liquidate maturing short-term debt (within one year). Maintaining adequate liquidity is much more than a corporate goal is a condition without which it could not be reached the continuity of a business. It is common to find reference to the fact that it is desirable to keep the company liquidity ratio higher than 1.00. That would prove the firm’s ability to repay short-term commitments, with the liquidation of short term assets. Any ration below 1.0 may mean that the business may not be generating cash enough to meet the short term obligations

The assessment of liquidity is usually done through the Current Ratio (CR = Current Assets/Current Liability)
2. BRIEF PROFILE OF SELECTED FMCG COMPANIES:

<table>
<thead>
<tr>
<th>HUL</th>
<th>Colgate</th>
<th>ITC</th>
<th>Nestle</th>
<th>Britannia</th>
<th>Marico</th>
<th>P&amp; G</th>
<th>Dabur</th>
<th>Godrej</th>
<th>Emami</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headquarters</td>
<td>Mumbai, Maharashtra, India</td>
<td>Mumbai, Maharashtra, India</td>
<td>Kolkata, WB, India</td>
<td>Bangalore, Karnataka, India</td>
<td>Mumbai, Maharashtra, India</td>
<td>Mumbai, Maharashtra, India</td>
<td>Ghaziabad (UP), India</td>
<td>Mumbai, Maharashtra, India</td>
<td>Kolkata, WB, India</td>
</tr>
<tr>
<td>Products</td>
<td>Foods, beverages, cleaning agents, personal care products, Water purifiers.</td>
<td>Cleaning agents, Personal care products</td>
<td>Consumer goods</td>
<td>Baby food, coffee, dairy products, breakfast cereals, confectioner y, bottled water, ice cream, pet foods</td>
<td>Bakery products, dairy products, Edible Oils, Hair Oils, Skin Care, Fabric Care,</td>
<td>Cleaning agents, Personal care products</td>
<td>Health Care, Personal Care, Oral Care, Food Home Care</td>
<td>Consumer goods</td>
<td>Hair care, skin creams, soaps and lotions, talcum powder, Ayurvedic health care products</td>
</tr>
<tr>
<td>Website</td>
<td><a href="http://www.hul.co.in">www.hul.co.in</a></td>
<td><a href="http://www.colgatepalmolive.co.in">www.colgatepalmolive.co.in</a></td>
<td><a href="http://www.itcportal.com">www.itcportal.com</a></td>
<td>Nestle.in</td>
<td><a href="http://www.britannia.co.in">www.britannia.co.in</a></td>
<td><a href="http://www.marico.com">www.marico.com</a></td>
<td>pg.com</td>
<td>Dabur.com</td>
<td><a href="http://www.godrej.com">www.godrej.com</a></td>
</tr>
</tbody>
</table>

3. OBJECTIVES

- To identify the nature and extent of the relationship between liquidity and profitability of ten leading FMCG companies in India.
- To check the validity of liquidity-profitability trade-off, for ten leading FMCG companies in India.

4. REVIEW OF LITERATURE

A brief review of the literature in this field has been attempted in the following paragraphs.

[8] Smith (1980) conducted a study on Profitability and Liquidity and suggested that working capital management directly influence risk and profitability of a firm. Hence it can be inferred that effective working capital management can increase the financial strength of a business.

[4] Eljelly (2004) has investigated the relation between profitability and liquidity by using Correlation and regression analyses and found that the cash conversion cycle was of more Importance as a measure of liquidity than the current ratio that affects profitability.

[5] Jain and Praveen Kumar (2006) viewed that working capital management practices assume vital importance in the smooth day-to-day functioning of business firms. While excess working capital can have an adverse impact on profitability, inadequate working capital can hold up production or sales operations of well managed business firms. Good working capital management is more crucial now than ever before in view of turbulence in the current business environment where competition is stiff and profit margins are low.

[2] Dong (2010) reported that the firms” profitability and liquidity are affected by working capital management in his analysis. From his research it was found that the relationships among these variables are strongly negative. These indicate that decrease in the profitability will occur due to increase in the liquidity ratio.

[3] Dr. Vivek Sharma (2011) has viewed that profitability and risk go hand in hand and that a firm earns good profit with moderate liquidity and at higher risk for which ten years data of Maruti Suzuki India Ltd. for a period of (2001-2010) has been studied.

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[6] Sandhar, Simranjeet Kaur (2013) has attempted to say that cardinality of liquidity management in any organization cannot be over emphasized. This is because either inadequate liquidity or excess liquidity may be injurious to the smooth operations of the organization.

5. RESEARCH METHODOLOGY

Sample size:
Ten leading companies under FMCG sector.

Sampling method:
Ten leading companies were selected on the basis of sales turnover.

Data Selection:
The source of data for this study was predominantly from secondary sources. The annual financial reports for the selected companies were used as a source of secondary data in order to compare and evaluate liquidity performance.

Period of Study:
The study has been undertaken for a period of 10 year from 2005-06 to 2014-15.

Tools used for analysis
In order to Analyse liquidity performance of the selected FMCG companies,
- Return on Investment: Profitability measure
- Current Ratio: Liquidity measure
- Spearman’s Rank Correlation: to find out the relationship between liquidity with profitability, and
- t-test: applied to test the hypothesis and draw conclusions.

HYPOTHESES FORMULATED
H₀: There is no relationship between Profitability and Liquidity in HUL.
H₀: There is no relationship between Profitability and Liquidity in Colgate.
H₀: There is no relationship between Profitability and Liquidity in ITC.
H₀: There is no relationship between Profitability and Liquidity in NESTLE.
H₀: There is no relationship between Profitability and Liquidity in BRITANNIA
H₀: There is no relationship between Profitability and Liquidity in MARICO
H₀: There is no relationship between Profitability and Liquidity in P&G
H₀: There is no relationship between Profitability and Liquidity in DABUR
H₀: There is no relationship between Profitability and Liquidity in GODREJ
H₀: There is no relationship between Profitability and Liquidity in EMAMI.
Table 1

<table>
<thead>
<tr>
<th>Year</th>
<th>HUL</th>
<th>COLGATE</th>
<th>ITC</th>
<th>NESTLE</th>
<th>BRITANNIA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>59.62</td>
<td>0.71</td>
<td>10</td>
<td>9</td>
<td>1</td>
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<tr>
<td>2006-07</td>
<td>66.37</td>
<td>0.74</td>
<td>9</td>
<td>7</td>
<td>2</td>
</tr>
<tr>
<td>2007-08</td>
<td>115.85</td>
<td>0.69</td>
<td>4</td>
<td>10</td>
<td>-6</td>
</tr>
<tr>
<td>2008-09</td>
<td>100.72</td>
<td>1.01</td>
<td>5</td>
<td>1</td>
<td>4</td>
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<tr>
<td>2009-10</td>
<td>85.26</td>
<td>0.84</td>
<td>7</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>2010-11</td>
<td>86.73</td>
<td>0.86</td>
<td>6</td>
<td>2</td>
<td>4</td>
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<tr>
<td>2011-12</td>
<td>76.63</td>
<td>0.83</td>
<td>8</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>2012-13</td>
<td>142.02</td>
<td>0.76</td>
<td>1</td>
<td>5</td>
<td>-4</td>
</tr>
<tr>
<td>2013-14</td>
<td>118.04</td>
<td>0.74</td>
<td>2</td>
<td>7</td>
<td>-5</td>
</tr>
<tr>
<td>2014-15</td>
<td>115.87</td>
<td>0.75</td>
<td>3</td>
<td>6</td>
<td>-3</td>
</tr>
</tbody>
</table>

Source: Computed with the help of figures from annual reports of respective companies

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Table 2 Rank correlation and t-test statistic of selected FMCG companies

<table>
<thead>
<tr>
<th></th>
<th>HUL</th>
<th>COLGATE</th>
<th>ITC</th>
<th>NESTLE</th>
<th>BRITANNIA</th>
<th>MARICO</th>
<th>P &amp; G</th>
<th>DABUR</th>
<th>GODREJ</th>
<th>EMAMI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spearman’s Rank Correlation:</td>
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<td></td>
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<td></td>
<td></td>
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<tr>
<td>Spearman’s Rank Correlation:</td>
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<tr>
<td>$r$</td>
<td>0.90</td>
<td>0.93</td>
<td>0.86</td>
<td>0.95</td>
<td>0.96</td>
<td>0.90</td>
<td>0.84</td>
<td>0.96</td>
<td>0.88</td>
<td>0.91</td>
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<tr>
<td>t-test statistic :</td>
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<td>Two tailed test</td>
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<tr>
<td>Degrees of freedom: (n-2) = 10-2 = 8</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$t_{cal.}$ value</td>
<td>5.95</td>
<td>7.21</td>
<td>4.81</td>
<td>8.47</td>
<td>10.11</td>
<td>5.70</td>
<td>4.40</td>
<td>10.02</td>
<td>5.18</td>
<td>6.17</td>
</tr>
<tr>
<td>$t_{crit.}$ value @ 5% LOS with 8 d.o.f</td>
<td>2.31</td>
<td>2.31</td>
<td>2.31</td>
<td>2.31</td>
<td>2.31</td>
<td>2.31</td>
<td>2.31</td>
<td>2.31</td>
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<tr>
<td>Decision</td>
<td>Rejected</td>
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<td>Rejected</td>
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</tbody>
</table>

Source: Computed

6. HYPOTHESIS TESTING
From the above table 2, we find that the calculated value of $t$ is more than the tabulated value (critical value), we fail to accept null hypotheses in all companies. It is concluded that there is positive relationship between profitability and liquidity for ten leading FMCG companies in India.

7. CONCLUSION
This work examined the relationship between profitability and liquidity on ten leading FMCG companies in India for the period of 2005-06 to 2014-15. It is observed for all the studied years a significant and positive correlation between liquidity and the profitability variables. This result contradicts the usual findings from the literature, indicating that for ten leading FMCG companies dilemma between liquidity and profitability do not exist.

The study was exploratory in nature and its conclusions are restricted to group of FMCG companies and the periods examined, that is the ten leading FMCG companies between 2005-06 to 2014-15. It’s hoped that the study has given its contribution to the financial area of knowledge by observing that for FMCG companies there is not a dilemma between Liquidity and Profitability, may be this is also true for other group of companies(sectors) or maybe it just a specificity of FMCG sector.

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