# An Analytical Study on Measuring Short Term Solvency Position of Selected Indian FMCG Companies

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**Abstract:** ***This study directed to know the short term creditworthiness of selected FMCG companies, and ability to get credit termand to meet short term obligations towards suppliers and other parties. To meet this objective and to know short terms solvency position of company, data were collected from annual reports and financial statements of respective company for the 5 accounting periods ranging from 2013-14 to 2017-18. The collected components were analyzed in excel sheet and current ratio, liquid ratio, and operating cash flow ratio has been calculated. To make data more meaningful and understandable mean, standard deviation, co-efficient of variance, cross-tabulation and charts were used. This study concludes thatITC is managing liquidity by having adequate and ideal current assets while Colgate and HUL are depending upon cash generated from operations of the business to meet short term obligations that indicates strong short term creditworthiness of all the selected companies; they can easily get the credit terms from their suppliers and short term loans from banking and financial institutions.***

**Keywords:** Liquidity, Suppliers, Creditworthiness, FMCG, Position

## 1. Introduction

Liquidity ratios are an important class of financial metrics used to determine a debtor's ability to pay off current debt obligations without raising external capital.

**Current Ratio:** This ratio measures the financial strength of the company. Generally 2:1 is treated as the ideal ratio, but it depends on industry to industry.

**Formula:** Current Assets / Current Liability

**Where:** Current Assets = Stock, Debtor, Cash and bank, receivables, loan and advances, and other current assets.Current Liability = Creditor, Short-term loan, bank overdraft, outstanding expenses, and other current liability

**Liquidity Ratio:** This ratio measures the financial strength of the company. Generally 1:1 is treated as the ideal ratio, but it depends on industry to industry.

**Formula:** Liquid Assets / Liquid Liabilities

**Where:** Liquid Assets = All current Assets except Stock i.e. Debtor, Cash and bank, receivables, loan and advances, and other current assets.Liquid Liabilities = Creditor, Short-term loan, bank overdraft, outstanding expenses, and other current liability

**Operating Cash Flow Ratio**: The Operating Cash Flow Ratio, a liquidity ratio, is a measure of how well a company can pay off its current liabilities with the cash flow generated from core business operations.

**Formula:** Operating Cash Flow Ratio= Cash flow from operations/Current Liabilities

**Where:** Cash flow from operations can be found on a company's statement of cash flows. Alternatively, the formula for cash flow from operations is equal to net income + non-cash expenses + changes in working capital.Current liabilities are obligations due within one year. Examples include short-term debt, accounts payable, and accrued liabilities.

## 2. Literature Review

**Billah et al. (2015)**analyzed liquidity position of selected public-listed companies in Malaysia. This study tested the use of cash flow ratios to measure liquidity by comparing with relevant traditional ratios. The empirical result showed statistical significant difference between these two types of ratios. In most cases cash flow ratios supported traditional ratios by providing additional insight in this research. Therefore, it is recommended to use these two types of ratios simultaneously in order to make conclusion about a firm's financial strength or weakness.

**Durrah et al. (2016)**explored the relationship between liquidity ratios and indicators of financial performance on food industrial companies listed in Amman bursa. The study found that there were no relationship between all liquidity ratios and the gross profit margin, while there is a weak positive relationship between the current ratio and each of the operating profit margins and the net profit margin, as the study pointed to the existence of a positive relationship between (quick ratios, defensive interval ratio) and operating cash flow margin. There is a positive relationship between liquidity ratios (current ratio, quick ratio, cash ratio) and return on assets.

**Hiadlovský (2016)** studied importance of liquidity analysis in the process of financial management of companies operating in the tourism sector in Slovakia. This research results reveal the low long-term level of average current and total liquidity for the 2011 to 2014 period and indicate moderate to weak relationship between selected liquidity and profitability ratios. As liquidity is one of the areas reflecting one side of company´s performance, its systematic and proper management may help companies achieve their goals on the way to excellence.

## 3. Research Methodology

**Objective** of the study is to know the short term creditworthiness of selected FMCG companies, and ability to get credit period for making short term liabilities and to meet short term obligations towards suppliers and other parties..To analyse the liquidity position of selected companies the study randomly selected three FMCG Companies and the financial data were collected for the five accounting periods ranging from 2013-14 to 2017-18, data were collected from annual reports and financial statements of selecetd companies.

**Research tools used for study:** Liquidity Ratios: Current ratios, Liquidity Ratio, Operating Cash Flow Ratio.

**Statement of Intended Contribution:** This study gives better understanding of liquidity and will be helpful to short term investors, banks, financial institutions, suppliers and other short term loan providers to assess the short term creditworthiness&liquidity position of companies.

## 4. Inter Company Analysis of Liquidity

### 4.1 Current Ratio

**Table 1:** Table showing current ratio

| Years & Statistics | Companies | | |
|---|---|---|---|
| | HUL | ITC | Colgate |
| 2013-14 | 1.03 | 1.90 | 0.78 |
| 2014-15 | 1.05 | 2.05 | 0.80 |
| 2015-16 | 1.03 | 1.65 | 0.93 |
| 2016-17 | 1.31 | 3.59 | 0.86 |
| 2017-18 | 1.02 | 2.77 | 1.08 |
| Mean | 1.09 | 2.39 | 0.89 |
| SD | 0.12 | 0.79 | 0.12 |
| CV | 8.78 | 3.04 | 7.29 |

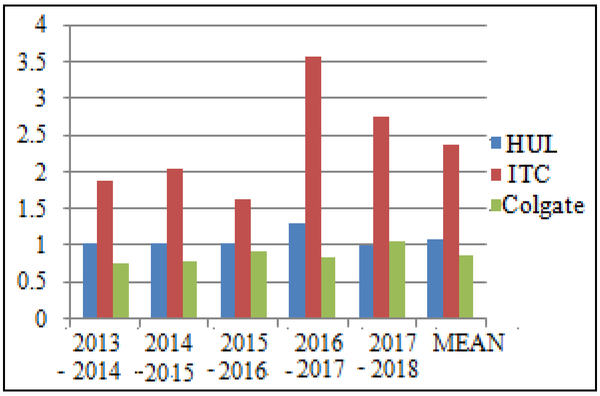


**Chart 1:** Chart showing comparison of current ratio

**Analysis & Interpretation:** The above table presents the comparison of current ratio between HUL, ITC and Colgate for 5 years which starting from April 2013 to March 2018. The above table also represents that the current ratio of HUL is highest in the year 2016-17 and lowest in the year 2013-14. On an average for last five years the current ratio of HUL is 1.09 which indicates that in overall the company is able to meet its short term obligations up to a certain extent and this company does not have any excess of working capital to meet short term unexpected obligations or contingency plan. The above table also represents that the current ratio of ITC is highest in the year 2016-17 and lowest in the year 2015-16. On an average for last five years the current ratio of ITC is 2.39 which indicate that in overall the company is very much efficient to meet its short term obligations and this company have certain amount of excess working capital to meet the short term unexpected obligations or short term contingency plan. The above table also represents that the current ratio of Colgate is highest in the year 2017-18 and lowest in the year 2013-14. On an average for last five years the current ratio of Colgate is 0.89 which indicate that in overall company is not so much efficient to meet short term obligations and this company does not maintain working capital to meet the short term unexpected obligations or short term contingency plan.

**Remarks:** From the above table and charts it is observed that the ITC Company has maintained current ratio ideally as per industry which shows the strong liquidity position of the company as compare to others.

### 4.2 Liquid Ratio

**Table 2:** Table showing liquidity ratio

| Years & Statistics | Companies | | |
|---|---|---|---|
| | HUL | ITC | Colgate |
| 2013-14 | 0.71 | 1.28 | 0.52 |
| 2014-15 | 0.76 | 1.38 | 0.50 |
| 2015-16 | 0.75 | 1.07 | 0.80 |
| 2016-17 | 0.98 | 2.11 | 0.57 |
| 2017-18 | 0.74 | 1.95 | 0.85 |
| Mean | 0.79 | 1.56 | 0.65 |
| SD | 0.11 | 0.45 | 0.17 |
| CV | 7.29 | 3.47 | 3.92 |

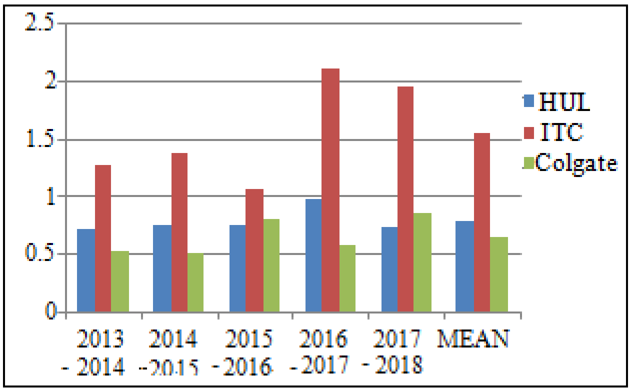


**Chart 2:** Chart showing comparison of liquidity ratio

**Analysis & Interpretation:** The above table presents the comparison of liquid ratio between HUL, ITC and Colgate for 5 years which starting from April 2013 to March 2018. The above table also represent that the liquid ratio of HUL is highest in year 2016-17 and lowest in year 2013-14. On an average for last five years the liquid ratio of HUL is 0.79 which indicates that in overall the company is able to its short term obligations up to a certain extent and this company does not have any excess of working capital to meet short term unexpected obligations or contingency plan. The above table also represents that the liquid ratio of ITC in highest in the year 2016-17 and lowest in the year 2015-16. On an average for last five years the liquid ratio of ITC is 1.56 which indicates that in overall the company is able to its short term obligations up to a certain extent and this company does not have any excess of working capital to meet short term unexpected obligations or contingency plan. The above table also represents that the liquid ratio of COLGATE in highest in the year 2017-18 and lowest in the year 2014-15. On an average for last five years the liquid ratio of ITC is 0.65 which indicates that in overall the company is able to its short term obligations up to a certain extent and this company does not have any excess of working capital to meet short term unexpected obligations or contingency plan.

**Remarks:** From the above table and charts it is observed that the ITC Company has maintained liquid ratio ideally as per industry which shows the strong liquidity position of the company as compare to others.

### 4.3 Operating Cash Flow Ratio

**Table 3:** Table showing operating cash flow ratio

| Years & Statistics | Companies | | |
|---|---|---|---|
| | HUL | ITC | Colgate |
| 2013-14 | 0.43 | 0.59 | 0.53 |
| 2014-15 | 0.35 | 0.80 | 0.74 |
| 2015-16 | 0.43 | 0.63 | 0.80 |
| 2016-17 | 0.69 | 1.46 | 0.69 |
| 2017-18 | 0.69 | 1.43 | 0.71 |
| Mean | 0.52 | 0.98 | 0.69 |
| SD | 0.16 | 0.43 | 0.10 |
| CV | 3.31 | 2.28 | 6.84 |

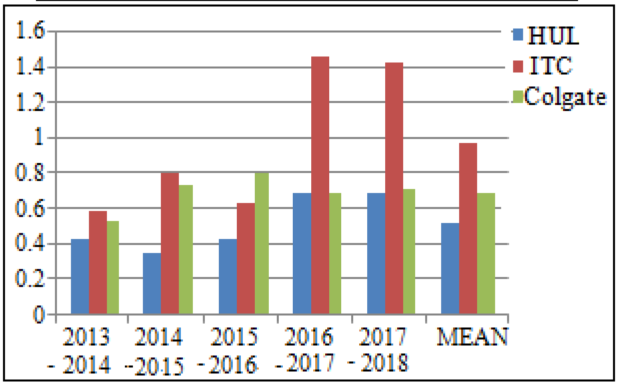


**Chart 3:** Chart showing comparison of operating cash flow ratio

**Analysis & Interpretation:** The above table presents the comparison of Operating cash flow ratio between HUL, ITC and Colgate for 5 years which starting from April 2013 to March 2018. The above table also represents that the Operating cash flow ratio of HUL is highest in the year 2016-17 and lowest in the year 2014-15. On the average for last five years the Operating cash flow ratio 0.52 which indicates that in overall the company is able to meet its short term obligations from operating cash flow ratio.The above table also represents that the Operating cash flow ratio of ITC is highest in the year 2016-17 and lowest in the year 2013-14. On the average for last five years the Operating cash flow ratio 0.98 which indicates that in overall the company is able to meet its short term obligations from operating cash flow ratio. The above table also represents that the Operating cash flow ratio of COLGATE is highest in the year 2015-16 and lowest in the year 2013-14. On the average for last five years the Operating cash flow ratio of COLGATE 0.69 which indicates that in overall the company is able to meet its short term obligations from operating cash flow ratio.

**Remarks:** From the above table and charts it is observed that the ITC Company and COGLGATE has maintained quite good operating cash flow ratio as per industry which shows the strong liquidity position of the company as compare to others.

## 5. Major Findings and Conclusion

**Materials:** To meet the objective of this study data were collected from financial statements of respective company for the 5 accounting periods ranging from 2013-14 to 2017-18. The collected components were analyzed in excel sheet and current ratio, liquid ratio, and operating cash flow ratio has been calculated. To make data more meaningful and understandable mean, standard deviation, co-efficient of variance, cross-tabulation and charts were used.

**Current Ratio:** The study found that ITC Company has maintained current ratio ideally as per industry which shows the strong liquidity position of the company as compare to others.

**Liquid Ratio:** The study found that ITC Company has maintained liquidity ratio in a manner that company is strong in meeting short term obligation and unforeseen events of the company very quickly as compare to others.

**Operating Cash Flow Ratio:** The data shows that all the three companies are generating handsome amount of cash from operations of the companies in descending order Colgate, HUL, and ITC.

### 5.1 Conclusion

From the data analysis it can be concluded that ITC is managing liquidity by having adequate and ideal current assets while Colgate and HUL are depending upon cash generated from operations of the business to meet short term obligations and unforeseen liabilities; that indicates strong short term creditworthiness of all the selected companies and they can easily get the credit terms from their suppliers and short term loans from banking and financial institutions.

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## Author Profile

**Pankaj Sharma** received the B.Com and M.Com degrees in Advanced Accounting & Auditing from C CSheth College of Commerce and S D School of Commerce in 2015 and 2017, respectively. He had qualified GSET and UGC NET - JRF examinations with commerce subject in 2016 and 2018, respectively. He had received Master of Philosophy degree in Accountancy from S D School of Commerce in 2018. He had one year of teaching experience in accountancy, marketing and management subjects. He had published 8 research papers and articles in the national and international journals. His areas of interest and work are forensic accounting, cloud accounting, collaborative accounting, social media advertising, marketing, corporate social responsibility, trade investment strategies of corporates etc. He now pursues Ph.D. in Accountancy as Senior Research Fellow at S D School of Commerce, Gujarat University.