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"Effect of Liquidity on Profitability of FMCG Companies in India"

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ABSTRACT

The ability of the running firm to pay its debts is thought as liquidity. Therefore, it is crucial to continuously monitor the company's liquidity condition, without which the organisation cannot continue. Business owners and Managers are concerned with coming up with a plan that would support both maintaining liquidity and boosting profitability. Profitability and liquidity are tightly correlated because one rises while the other falls. Profitability and liquidity are two key factors that might affect a company's overall performance and capacity to survive. Profitability demonstrates an organization's capacity to make money from investments, whereas, liquidity measures its capacity to settle short-term liabilities. A study is conducted on a sample of FMCG companies to see whether liquidity effects profitability. The top five FMCG businesses were chosen for the survey, which is based on data collected over a five-years period. The study's findings indicate that neither the fast ratio nor the current ratio have an impact on return on equity, return on capital employed, or return on assets. The effect of analysis was carried out using SPSS which implies that the profitability of FMCG Companies is unaffected by liquidity.

Key Words : Liquidity, Profitability, FMCG Companies, Current Ratio, Quick Ratio, Return on Equity, Return on Assets, Return on Capital Employed.

INTRODUCTION

One of the main economic sectors in India is the fast-moving consumer goods (FMCG) industry. Consumer packaged goods having a high turnover rate — i.e., those which are created, delivered, advertised, and consumed quickly — as to what define it. Producing,

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distributing, and marketing fast-moving consumer goods are primarily the responsibilities of the consumer-packaged goods (CPG) or fast-moving consumer goods (FMCG) industries. The fourth-largest sector of the Indian economy is the FMCG Sector. [1] 50% of industry sales are made up for household and personal care products, followed by healthcare (31-32%) and food and beverage (18-19%). [1]. The FMCG sector's revenue in India has increased at a rate of 21.4% over the past ten years. [2]. The FMCG sector's revenues significantly increased between 2011 and 2017 and 2018, going from US$ 31.6 billion to US$ 52.8 billion. [3]. The FMCG sector in India is projected to develop at a CAGR (Compounded Annual Growth Rate) of 27.9%, reaching a total of US$103.7 billion by 2020. [1]. In addition to the above, it is anticipated that the rural FMCG market will expand at a CAGR of 14.6%, reaching US$100 billion in 2020 and US$220 billion in 2025. [1]. The rural environment contributes 45% of the industry's overall revenue, while the urban environment accounts for 55% of it. [4]. In India, more than 65% of the population lives in rural areas, and they spend almost 50% of their entire income on FMCG goods. [5]. By 2025, 850 million individuals in India are expected to shop for consumer items online.

A company's liquidity is a measure of its capacity to settle its short-term debts. You can discover if you have the ability to meet your upcoming liabilities by looking at your liquidity ratio. This indicates that you have enough cash on hand, in your bank account, or in assets that can be rapidly turned into cash to cover your expenses. It aids in comprehending a company's cash flow situation, which affects the company's short-term financial condition. Lower numbers indicate financial difficulties, whereas larger numbers indicate a stable financial situation. The ability of a business to create money (profit) in relation to sales, balance sheet assets, operating costs, and shareholders' equity over a given period of time is measured and evaluated by analysts and investors using profitability ratios. They demonstrate, how well a business uses its resources to generate profit and shareholder value. Profitability ratios, in general, gauge how effectively your business converts sales into profits. Your capacity to convert sales into earnings is measured by your profit margins. The ability to employ assets to generate net income is measured by return on assets. Your net income is compared to shareholder equity via return on equity.

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According to past studies, liquidity has a substantial impact on company profitability and is increasingly vital for a company's survival in the short and medium term. This essay makes an effort to examine how liquidity affects the financial performance of particular FMCG Firms.

Review of Literature

- Malik et al., (2016) in their study "Impact of Liquidity on Profitability: A Comprehensive Case of Pakistan's Private Banking Sector", found a statistically significant relationship between bank liquidity and return on assets. The study was conducted for a period of five years on 22 private sector banks.

- Tamragundi, A., & Vaidya, P. (2016) in their study "Liquidity–Profitability Relationship: A Study of ten Leading FMCG Companies in India", found that there exists a very strong positive relationship between liquidity and profitability of the selected FMCG companies in India. The study was based on top ten FMCG companies in India and the period of study was from 2005 to 2015.

- Pradhan, R., & Shrestha, D. (2016) in their study "Impact of Liquidity on Bank Profitability in Nepalese Commercial Banks" found that increase in liquidity ratio and quick ratio had a negative impact on return on equity and return on assets. The study was conducted on Nepalese commercial banks.

- Ibrahim, S. (2017) in his study "The Impacts of Liquidity on Profitability in Banking Sectors of Iraq: A Case of Iraqi Commercial Banks" found that profitability is positively affected by liquidity. The study was conducted on five Iraqi banks over the period 2005 to 2013.

- Rodney Bwacha, C., & Xi, J. (2018) in their study "The Impact of Liquidity on Profitability" found that only deposit to asset ratio had a significant impact on profitability measured by return on equity and other liquidity ratios did not have a significant impact on profitability of banks. The study was conducted for a period of ten years and the sample included 50 leading banks from Asia, Europe and North America.

- SHRESTHA, B. (2018) in her study "Liquidity Management and Profitability of Commercial Banks in Nepal" found that liquidity does not have a significant impact on profitability of commercial banks in Nepal. The study was conducted for a period of five years on Nepalese commercial banks.

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Need for the study

For every organisation to survive, liquidity and profitability are absolutely essential. According to earlier studies, if one rises, the other does as well, and vice versa. Therefore, it is important to determine as to whether liquidity has any effect on the profitability of FMCG companies, because if liquidity affects FMCG firms' profitability, they will need to strike a balance between the two to prevent investing too much money in liquid assets and jeopardising profitability.

Objective

- Analyze the liquidity and profitability performance of selected organisations.
- Evaluate the effect of liquidity on profitability.
- To investigate the connection between some particular FMCG firms' liquidity and profitability.

Hypothesis

❖ Liquidity Ratios have significant effect on profitability ratios of selected FMCG companies.

❖ There is relationship between Liquidity and profitability of selected FMCG companies.

Methodology

The analysis makes use of secondary data taken from the chosen companies' annual reports. The current ratio and quick ratio are examples of liquidity ratios, return on equity, return on capital employed and return on assets which are examples of profitability ratios. The study is carried out over a five-year period, from 2018 to 2022. Using SPSS, the impact analysis was conducted. The five top FMCG companies — HUL, ITC, Nestle, Britannia, and Marico Ltd. — were chosen for the study. The influence of liquidity on profitability was evaluated using a straight-forward linear regression analysis.

Data Analysis

The data which has been used is secondary data extracted from the annual reports of the selected FMCG companies.

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Liquidity & Profitability Performance Selected companies

Companies	Year	2022	2021	2020	2019	2018
HUL	CR	1.34	1.26	1.31	1.36	1.29
	QR	0.98	0.95	1.02	1.07	1.02
	ROE	18.08	16.76	83.89	78.8	74.02
	ROA	12.64	11.67	34.37	33.78	30.53
ITC	CR	2.7	3.13	4.02	3.07	2.77
	QR	1.82	2.2	3.13	2.28	1.95
	ROE	24.52	22.08	23.63	21.5	21.83
	ROA	20.05	18.2	20.11	17.85	17.99
NESTLE	CR	1.05	1.68	1.74	2.55	2.64
	QR	0.45	1.11	1.16	2.03	2.03
	ROE	102.89	103.12	102.58	43.74	35.81
	ROA	26.12	26.36	27.44	19.86	16.64
BRITANNIA	CR	0.93	1.21	1.45	1.94	2.03
	QR	0.61	0.91	1.16	1.49	1.59
	ROE	66.72	53.02	34.72	27.78	29.29
	ROA	22.89	23.73	20.46	19.85	20.48
MARICO LTD.	CR	2.06	2.11	2.34	2.35	2.45
	QR	1.26	1.45	1.31	1.28	1.07
	ROE	38.14	36.44	34.86	32.35	23.61
	ROA	25.86	24.67	24.34	23.72	17.86

Source : Annual Report of Companies

The above table shows the liquidity and profitability ratios of selected companies from 2018-2022.

Descriptive Statistics

Average Ratios	HUL	ITC	NESTLE	BRITANNIA	MARICO LTD.
CR	1.31	1.14	1.93	1.51	2.26
QR	1	2.27	1.35	1.15	1.27
ROE	54.3	22.71	77.62	42.31	33.08
ROA	24.6	18.84	23.28	21.48	23.29

Source : Ratios calculated from Annual Report of Companies

Effect of Current Ratio and Quick Ratio on Return on Equity

ANOVA[a]

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Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	631.439	2	315.719	.544	.648[b]
	Residual	1160.850	2	580.425		
	Total	1792.289	4			

a. Dependent Variable: Return on Equity *SPSS Output*

b. Predictors: (Constant), Quick Ratio, Current Ratio

In the output above, we can see that the predictor variable Current Ratio is not significant because p-value is 0.648, which is greater than common alpha level of 0.05; this indicates that it is statistically not significant. So, there is no significant impact of Current Ratio and Quick Ratio on Return on Equity.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	80.459	36.167		2.225	.156	-75.157	236.075
	Current Ratio	-22.958	49.537	-.781	-.463	.689	-236.100	190.184
	Quick Ratio	8.618	71.375	.204	.121	.915	-298.484	315.720

a. Dependent Variable: Return on Equity *SPSS Output*

In the coefficients table, we can see none of the predictor variables have shown a significant impact on the dependent variable i.e. ROE.

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Effect of Current Ratio and Quick Ratio on Return on Capital Employed

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	515.331	2	257.666	9.508	.095[b]
	Residual	54.199	2	27.099		
	Total	569.530	4			

a. Dependent Variable: Return on Capital Employed *SPSS Output*

b. Predictors: (Constant), Quick Ratio, Current Ratio

In the output above, we can see that the predictor variable Current Ratio is not significant because p-value is 0.095, which is greater than common alpha level of 0.05; this indicates that it is statistically not significant. So, there is no significant impact of Current Ratio and Quick Ratio on Return on Capital Employed.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	76.027	7.815		9.728	.010	42.402	109.652
	Current Ratio	-22.794	10.704	-1.376	-2.130	.167	-68.849	23.261
	Quick Ratio	11.098	15.422	.465	.720	.546	-55.259	77.456

a. Dependent Variable: Return on Capital Employed *SPSS Output*

In the coefficients table, we can see none of the predictor variables have shown a significant impact on the dependent variable i.e. ROCE.

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Effect of Current Ratio and Quick Ratio on Return on Assets

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	15.736	2	7.868	3.807	.208[b]
	Residual	4.133	2	2.067		
	Total	19.870	4			

a. Dependent Variable: Return on Assets *SPSS Output*

b. Predictors: (Constant), Quick Ratio, Current Ratio

In the output above, we can see that the predictor variable Current Ratio is not significant because p-value is 0.208, which is greater than common alpha level of 0.05; this indicates that it is statistically not significant. So, there is no significant impact of Current Ratio and Quick Ratio on Return on Assets.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	27.635	2.158		12.805	.006	18.349	36.921
	Current Ratio	1.515	2.956	.490	.513	.659	-11.203	14.234
	Quick Ratio	-5.954	4.259	-1.335	-1.398	.297	-24.279	12.372

a. Dependent Variable: Return on Assets *SPSS Output*

In the coefficients table, we can see none of the predictor variables have shown a significant impact on the dependent variable i.e. ROA.

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Correlation Analysis:

Pearson Correlation Coefficients between variables of selected 5 FMCG Companies

Correlations

		Current Ratio	Quick Ratio	Return on Equity	Return on Capital Employed	Return on Assets
Current Ratio	Pearson Correlation	1	.941*	-.590	-.938*	-.767
	Sig. (2-tailed)		.017	.295	.018	.130
	N	5	5	5	5	5
Quick Ratio	Pearson Correlation	.941*	1	-.532	-.830	-.874
	Sig. (2-tailed)	.017		.356	.082	.052
	N	5	5	5	5	5
Return on Equity	Pearson Correlation	-.590	-.532	1	.676	.641
	Sig. (2-tailed)	.295	.356		.211	.244
	N	5	5	5	5	5
Return on Capital Employed	Pearson Correlation	-.938*	-.830	.676	1	.788
	Sig. (2-tailed)	.018	.082	.211		.114
	N	5	5	5	5	5
Return on Assets	Pearson Correlation	-.767	-.874	.641	.788	1
	Sig. (2-tailed)	.130	.052	.244	.114	
	N	5	5	5	5	5

Source : Computed by the Author

*. Correlation is significant at the 0.05 level (2-tailed).

Pearson correlation coefficients for the variables are used to assess the relation between liquidity and profitability. Profitability is measured by Return on assets (ROA), Return on Capital Employed and Return on investments (ROI).

Findings

1. The average current ratio of HUL was 1.31, which is below the accepted standard of 2:1. The quick ratio had an average of 1.00, which is the standard of 1:1. The company had an

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average return on equity of 54.31 for the period of study, which is very good. The average return on capital employed was 61.48 and average return on assets of the company was 24.59. So, the liquidity performance of the company was not very good but company has performed very well in terms of profitability.

2. The average current ratio of ITC was 1.14, which is below the accepted standard of 2:1 and quick ratio had an average of 2.27, which is also good as per the accepted standard. The return on equity of the company had an average of 22.71, while average return on capital employed 30.02 & average return on assets of the company was 19.34 for the aforesaid period of study. So, the company has managed to maintain a good liquidity position with a fair profitability performance over the said period of study.

3. The average current ratio of Nestle was 1.93 with an average quick ratio of 1.35, which means company had a good liquidity position for the said period of study. The average return on equity of the company was 77.62 with average return on assets of 23.28 and ROCE was 48.84 for the said period of study. The company had shown a fair liquidity performance with good profitability over the same period of study.

4. Britannia had an average current ratio of 1.51 with average quick ratio of 1.15 over the period of study. The average return on equity was 42.31 with average return on assets of 21.48 while the average of return on capital employed was 48.58 for the same period of study. So, the company's liquidity performance was not good, but it has shown a good profitability performance over the said period of study.

5. Marico Ltd. had an average current ratio of 2.26 with average quick ratio of 1.27, which is also good as per the accepted standard. The average return on equity was 33.08 with average return on assets of 23.29 & average of return on capital employed was 38.15 for the period of study. Therefore, the company has managed to maintain a good liquidity position with a fair profitability performance over the said period of study.

CONCLUSION

The results from regression analysis show that Current ratio and Quick Ratio did not have a significant impact for Return on Equity, Return on Capital Employed, and Return on Assets of the selected FMCG companies, which means liquidity does not have an impact of profitability of FMCG companies. The results of the study are based on selected companies in FMCG sector and this might not be applicable to any other sector.

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