PROFITABILITY AND LIQUIDITY OF IT SECTOR COMPANIES IN INDIA

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Abstract

India is favourite destination for information technology (IT) and information technology enabled services (ITeS) in the world. Indian IT industry has become a booster for economy contributing substantially to the GDP, urban employment and exports. Indian companies have become dependent on the IT & ITeS service providers for enhancing the efficiency of their business processes. Nasscom expects the IT services sector in India to touch US$ 225 billion by 2020. Some of the IT companies include Infosys, TCS, Wipro, Tech Mahindra , Mindtree, Polaris, Mphasis, Oracle Financial Services(formerly iFlex) etc. Liquidity and profitability in such industries is very volatile. This review has been designed to focus the importance and parameters of assessment of profitability & Liquidity of IT industry of india.

Market Size of IT industry

India's total IT industry's (including hardware) share in the global market stands at 7 per cent; in the IT segment the share is 4 per cent while in the ITeS space the share is 2 per cent. Large integrated players consisting of both Indian and international service providers dominate the industry. The enterprise software market in India reached US$ 3.92 billion in 2013, registering a growth of 13.9 per cent over 2012 revenue of US$ 3.45 billion, according to Gartner.

Investments

Core competencies and strengths of Indian IT industry have placed it on the international canvas, attracting investments from major countries (Brealey and Myers.,2003).Between April 2000 and June 2013, the computer software and hardware sector attracted cumulative foreign direct investment (FDI) of Rs 53,757.60 crore (US$ 7.97 billion), according to data released by the Department of Industrial Policy and Promotion (DIPP).

Road Ahead

Information Technology has been gaining importance in small and medium business activities; this sector has potential for impressive growth and is estimated at approximately US$ 230 billion–US$ 250 billion by 2020.

Profitability and liquidity trend in IT industries of India

Indian IT industry is going through wave of rejuvenation, with almost all top firms—with the exception of Wipro—reporting powerful double-digit revenue growth in 2012-13. Infosys, TCS, HCL Technologies Ltd and Wipro, have all recorded an average 13% year-on-year growth in revenue in 2012-13 which was nearly twice the growth rate in the same period last year.

Profitability and liquidity management is of crucial importance in financial management decision (Luther., 2007).

Profitability is firm's ability to generate earnings and earnings are must for survival and growth of companies (Nandi., 2011). Various people like owners, shareholders, managers are interested in company's profits as it is the source to get back their investment made into the firm. So management uses profitability ratios as a measure of their performance (Pandey., 2004). The profit of a business is the difference between its revenues and its costs. Profitability calculations help in making comparison of business profits on year to year basis and also help to compare the profitability of different businesses.

Liquidity means the capacity of the firm to convert the assets into realizable value in money. It measures the ability of the firm to honor all the maturing

Obligations. No firm can survive without liquidity. A firm not making profit may be considered as sick, but having no liquidity may soon meet its downfall and ultimately die. Liquidity management has thus become a basic and broad aspect of judging the performance of corporate entity (Altman., 1968) It is, therefore, essential to maintain an adequate degree of liquidity for smooth running of the business operations. The liquidity should be neither excessive nor inadequate (Beaver.,1967). Excessive liquidity indicates accumulation of idle funds, which do not earn any profit for the firm and inadequate liquidity not only adversely affected the credit worthiness of the firm but also interrupts the production process and hampers its earning capacity to a great extent.

The most favourable financial performance could be achieved by a company that can trade off between profitability and liquidity performance indicators. The purpose of this study is to find out the relationship between liquidity performance indicators and profitability as well as to make comparison of the same between four leading IT companies for a period of 3 years.

2. Literature Survey -

Review of related literature is an important step in undertaking research. It helps in clarifying and defining the problem, stating objectives, formulating hypotheses, selecting appropriate design and methodology of research as well as interpreting the results in the light of the research work already undertaken (Frigo and Litman., 2002). In this section, an endeavor has been made to provide an overview of various aspects of this study through the review of existing literature. The sources referred include various journals, books, doctoral theses, working papers, reports, magazines related to human resource, internet sites, newspapers etc.

Here are the reviews of the previous researches related with the present study:

Smith and Begemann (1997) studied if the maximization of the firm's returns could threaten its liquidity, and the pursuit of liquidity had a tendency to dilute returns. They analyzed the relation between working capital measures and return on investment (ROI)

Chen and Shimerda (1981) present a summary of the financial ratios used in a number of early studies which use the financial ratios for analysis and prediction. They note that there is an abundant 41 different financial ratios which are found useful in the earlier studies. They reconcile by judgement the factors in the earlier studies into financial leverage, capital turnover, return on investment, inventory turnover, receivables turnover, short-term liquidity, and cash position.

Dos et al. (1993) studied statistical correlation between IT spending and performance measures such as profitability or stock’s value. It is found that there is an insignificantcorrelation between IT spending and profitability measures.

Begley and Feltham., (1999) conducted a study on Ratio Variables on which he found three different uses of ratio variables in aggregate data analysis.

Eljelly (2004) examined the relation between profitability and liquidity measured by current ratio and cash gap (cash conversion cycle) on a sample of joint stock companies in Saudi Arabia using correlation and regression analysis. They found a negative relationship between profitability and liquidity indicators.

García-Teruel and Solano (2007) studied the effects of working capital management over companies ROA. They observed 8872 enterprises and found out that shortening cash convertion cycle had significant effect over companies’ profitability.

Raheman and Nasr (2007) studied the relationship between Working Capital Management and profitability for Pakistanian companies listed on Karachi Stock Exchange. Between their findings, it was observed a significant negative relationship between company’s liquidity and profitability.

SAMILOGLU & DAMIRGUNES (2008) said that even though the profitability is constantly positive, inaccurate working capital management procedures may lead to bankruptcy of the firm.

NANDI (2011) made an attempt to examine the influence of working capital management on corporate profitability. For assessing impact of working capital management on profitability of National Thermal Power Corporation Ltd. during the period of 10 years i.e., from 1999-2000 to 2008-09 Pearson‟s coefficient of correlation and multiple regression analysis between some ratios relating to working capital management and the impact measure relating to profitability ratio (ROI) had been computed and applied.

KARADUMAN, AKBAS & CALISKAN (2011) have tried to shed light on the empirical relationship between efficiency of working capital management and corporate profitability of selected companies in the Istanbul Stock Exchange for the period of 2005-2009.

Current challenges of profitability and liquidity of IT sector companies in india

The major limitation is that the study is based on financial statement analysis and assessment of one company with a different company. This can give valuable clues and add value in the existing field of academics but regrettably, differences in accounting methods between companies occasionally create it difficult to evaluate the companies' financial data. Also, the quality of the study depends purely upon the accuracy, reliability and quality of secondary data.

Moreover, the study is limited to study of only four IT companies and also for just span of three years. Therefore the current challenges

- To identify the factors that impact profitability of IT companies.
- To identify the factors that impact liquidity of IT companies.
- To study the impact of profitability and liquidity on IT companies.
- To make comparative study of four leading IT companies.
- To study the initiatives taken by the government and companies to boost their profit margins
- To find the importance of having liquid assets in comparison to fixed capital
- To make inter firm and intra firm comparison between top four IT companies.

Conclusion

In the present competitive world, IT organizations are filled with pressure to have sound financial statements. Liquidity and profitability in such industries is very volatile. The scope of the study includes calculation of various profitability ratios- gross profit ratio, net profit ratio, operating profit ratio, return on investment ratio etc and liquidity ratios-current ratio and quick ratio. The most favourable financial performance could be achieved by a company that can trade off between profitability and liquidity performance indicators.

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