Working Capital Management
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Lecture - 07
Trade-off between Profitability and Risk - II

Welcome students. So in the previous class we were talking about the a company Hypothetical Limited. The company's financial requirement was given to us and we had to work out that how they should manage the funds. What are the different sources they should manage the funds from so that the cost of funds becomes minimum. The total cost of the funds goes down and in that case we have seen that we have different approaches as we have been talking about.

We have different approaches like say your conservative, aggressive, and the hedging or matching approach. So we assumed in the previous class that say in the normal circumstance it is not possible to use the aggressive approach. It is not the wall game of every firm or every organization. So largely the firms use either the conservative approach or the matching approach or the hedging approach.

Even using the hedging approach is also requiring a lot of disciple, financial discipline, punctuality, regularity and they have to be very careful that any payment when becoming due to be made that should be made on time as I have told you in some say previous classes that financial discipline as well as the short term funds management is concerned demands that if any payment is due to be made to any supplier maybe tomorrow say till 10 o'clock or 10 am the cheque should reach him it is better to send the payment by today evening rather than delaying it by tomorrow evening.

That is not considered as a good thing because what happens. There is a symbiosis. A kind of a proper arrangements, maybe our supplier is depending upon us or the supplier of any firm is depending upon that firm that by tomorrow say today say if it is 6 December and tomorrow 7 December he is expecting a cheque of 3 lakh rupees from the company xyz limited that I have supplied to them and tomorrow is the due date and they will make me the payment and if the company delays the payment right.

So he is expecting that the payment will arrive at or the cheque will arrive at 10 am tomorrow and that same cheque he will deposit in the bank and against that cheque he will write another cheque to his supplier or to anybody to whom he has to make the payment or he has to make the payment to his workers or maybe to somebody else and he has made the arrangements like that I will receive the payment in the one hand and immediately after that I will make the payment to my supplier or to somebody to whom I have to make the payment.

So if you delay the payment by tomorrow, if the firm xyz limited delays the payment, if they take it lightly that not tomorrow morning 10 am it may be sent by 5 or 6 pm in the evening or maybe next day, we can delay it by 1 day. So what is happening? The cost of the say financial indiscipline of the xyz limited the say total arrangement of the xyz suppliers are disturbed and like that it is disturbing the total symbiosis.

His supplier's arrangements will also be disturbed. His employees' arrangements will also be disturbed. Everybody will be disturbed. So it is not considered as a good practice. So we have to be sure that anytime if any payment is due to be made to any of the suppliers or any of the stakeholders, that should be made, it is better to make the payment before time but never delay the payment beyond the due date or the due time.

So for that reason we assume that it is not possible to follow the aggressive approach. It is better to follow the say not conservative I would say because that will increase the financial cost beyond a level. So if it is possible to follow the hedging approach or matching approach then it is fine. Otherwise, what we can do is we can have a trade-off. So we saw in the previous class that how we can work out a trade-off.

We have seen that total requirement of the company, there is a minimum and the maximum requirement was 6900 was the minimum requirement and say 9000 was the maximum requirement over the period of 12 months and when we calculated it by following a conservative approach our cost went up. That was somewhere 720 million rupees or 1000 Rs or whatever it is. So I think that was too high.

And when we worked it out by using a say your the matching approach or the hedging approach the cost came down to 581 million rupees. So means here also you can say that we have 2 extremes say. Because under the matching approach you have 0 net working capital. There is no cushion that if any of the current assets are not convertible into cash due to any reason because how do we move to use the cash in the firm.

First of all we use the cash which is in hand then cash at bank. Then we say sell the marketable securities which are there with the firm as a very short term investments. We sell the marketable securities. Once these 2 cash and the marketable securities are fully exhausted then we try to generate funds from the sundry debtors and sundry debtors because they will not make the payment to the firm before the due date normally.

So the firm can say offer them discount. They can resort to a strategy that okay a payment from some supplier is due after 15 days. So if can make the payment tomorrow then I think it wil serve the purpose. So how we can induce him so that he can prepone the payment date by 15 days. So for that he would like to have something that some incentive should be given to him. So firm can decide that okay let us give him some discount.

Maybe we can give him 1 or 2% discount of the total payment, cash discount especially so that he can prepone the, he should have the reason to prepone the payment. So if we give him the discount so we can say okay after giving discount for 2% or by 2% or up to 2% he is going to make the payment to us. So that can be tried. So that will serve the purpose and if we need more funds then the other debtors also can be induced by giving the discount.

And if it is not possible then there is a way that we can take the help of the bank. Whatever the credit sales bills firm has whatever the credit sale bills the firm has normally those debtors are going to pay on the due date and that if the due date is after say a month or maybe after 2 months or 45 days I think giving the discount may not be a right proposition because they would expect a big amount of discount say large amount of discount maybe 2, 3, 4%.

That may not be in the interest of the firm. So what the firm can do? Those credit sale bills can be got discounted from the banks. Banks easily give the money by keeping those bills as a security because banks know it that this firm has sold on credit to the different people in the market and those people bank should be knowing or normally banks know the credit rating of the buyers.

If the credit rating or the financial reputation of those buyers is good in that case banks normally do not mind in buying the bills. So banks purchase the credit sale bills and then they release the funds up to 80% of the credit sale bill and 20% they release it on the settlement of the amount which is paid by the debtor either to the bank or to the company and finally on the due date or on the settlement date.

So it means in that way we can generate the funds and if if anything is means not working or maybe all the avenues have been fully exhausted then you have to go for the selling of inventory in the market. But that is as you can call it as the least liquid asset. You cannot convert the inventory into cash as and when you want it because if we want to sell the inventory in the market **even** either we have to give the huge discount or we have to sell it on the credit in the market so that is not going to provide any liquidity to the firm.

So we should be careful that when you are following a matching approach or hedging approach in that case what is happening you have no cushion means there is a 0 amount of the funds coming from the long term sources. We are or what we had a created a watertight compartment. The short term, all short term needs or current assets fully will be financed from the short term sources only. No funding will come from the long term sources only.

So it means on the on the say say pretext of saving the financial cost we are creating the liquidity problem so we can say that as we saw in the previous class that we have see that yes cost is coming down to 580 million rupees from 720 million rupees but the risk is also going up. Net working capital is 0. Liquidity position is quite tight. So we can say that what to talk of aggressive even to some extent your hedging approach is also one extreme.

So we try to find out our trade-off and then we saw that we can have a trade-off so we changed the situation that okay what is the maximum requirement that is 9000 and what is the minimum requirement 6900. So you divide this maximum plus minimum divided by 2 and when we worked out this requirements we saw that that requirement has changed, went up little up means average amount when we worked out that amount went up that is from 6900 minimum to the 7950.

So we can say that we have taken the average amount that is 7950 and when we worked out that average amount of 7950 we saw that this amount, not 6900 but 7950 will come from the long term sources. And the remaining amount we worked out for every month which was the seasonal requirement and when we worked out the seasonal requirement so that seasonal requirement we could find out that the total of the seasonal requirement was that is somewhere 2700 Rs.

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Trade-off between Hedging and Conservative Approaches

Month	Total funds required	Permanent requirements	Seasonal Requirements
(1)	(2)	(3)	(4)
January	Rs. 8,500	Rs. 7,950	Rs. 550
February	8,000	7,950	50
March	7,500	7,950	0
April	7,000	7,950	0
May	6,900	7,950	0
June	7,150	7,950	0
July	8,000	7,950	50
August	8,350	7,950	400
September	8,500	7,950	550
October	9,000	7,950	1,050
November	8,000	7,950	50
December	7,500	7,950	0
			2,700

Then we worked out the requirement, we could see that 7950 will come from the long term sources and the remaining will come from the short term sources. So we worked out the seasonal requirement and when we worked out the seasonal requirement the total was say total as compared to the say previous case which was 11600 for the whole of the year divided by 12 we could find out that whole of the year now the requirement is 2700 from the which is the seasonal fluctuating requirement.

When we divided it by 12 so monthly requirement worked out as 225. Then we calculated the financial cost by applying the interest rate of 3% on the short term finance and 8% on the long term finance and then we worked out the cost and the cost came out as that is total cost came down and that cost worked out was 642.75 or you can say 643 which is quite less from 720 but little more from 580. It is in between.

So what we have done here is that we have increased the liquidity so by increasing the liquidity you are reducing the risk and we are increasing the finance cost little bit which will impact the profitability but profitability is not everything for the firms along with the profitability you have the reputation of the firm, financial reputation of the firm also and that should also be not at stake.

So in that case rather than means saving only upon the cost and taking huge risk it is better for the firms that you increase the financial cost little bit and you minimize the risk to the extent it is possible by increasing the net working capital and by increasing the liquidity right.

So because it was very totally done in the previous class so I thought of say just having a discussion on this case that while we followed the trade-off approach which was the in between approach of conservative as well as the hedging approach and we assumed that in the normal circumstance following the aggressive approach or the negative working capital may not be possible for all the firms.

So it is better to go for the trade-off between the hedging and the hedging and the conservative approach right. So now we will see certain other important aspects with regard to managing the working capital. We have been talking that the level of current assets should be as low as possible. We have seen in the say previous discussion also and a case also the balance sheet when we saw that total assets were 14000 where 6000 or 5400 were from the say current assets and 8600 are the say your fixed assets or the long term assets.

So then we calculated the cost. Then we calculated the profits.

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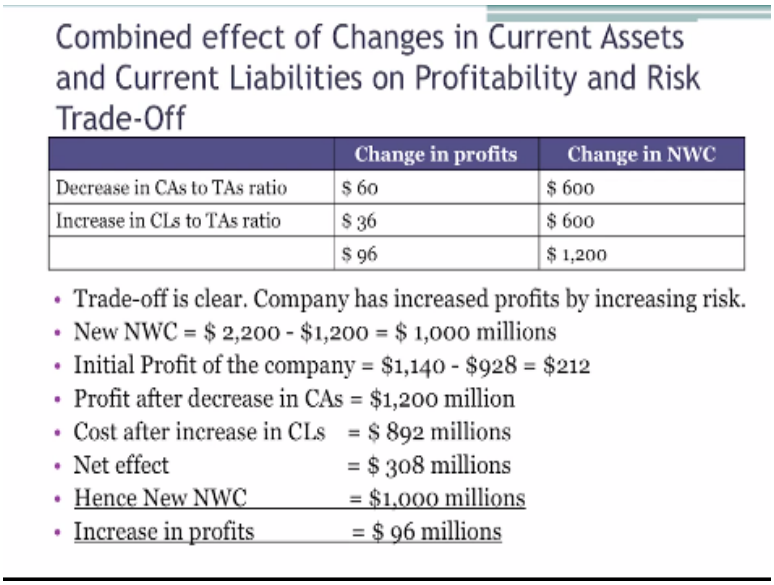

Then we calculated the liquidity, net working capital when we jacked up the level of current assets from 5400 to 6000 by 600 Rs or million or whatever it is. You have seen that as the amount of the current asset increases being current asset being least productive our cost has increased, profitability has declined though the liquidity has improved. Then we reduced the level of current assets then we saw that liquidity has gone down.

Risk has increased but the profitability has gone down. So means that the conclusion is that current assets are least productive assets. We have seen in the beginning classes also that neither inventory has any return nor credit sales has any return nor cash has any return. Only marketable securities are giving us some return. So in that case ultimately means we are bound to keep the current assets in the balance sheet of the firm but that should be as low as possible.

So we have seen we have made a small analysis for your say help that you feel convinced that yes level of current asset is impacting the profitability. So if you see the this these 3 situations we have created. You can say that these are the say 3 different approaches right. One approach is like you can say the first approach is the conservative approach which we are saying in the column A. Column B is the hedging approach or matching approach.

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Effect of Different Levels of Current Assets

Policies

	A	B	C
	Rs.	Rs.	Rs.
Sales	15,00,000	15,00,000	15,00,000
EBIT	1,50,000	1,50,000	1,50,000
Fixed Assets	5,00,000	5,00,000	5,00,000
Current Assets	5,00,000	4,00,000	3,00,000
Total Assets	10,00,000	9,00,000	8,00,000
ROI	15.00%	16.67%	18.75%
CA/FA Ratio	1.00	0.80	0.60

And column C is the here we are following the aggressive approach right. So if you see these so look at the last column. That column is that is the ratio of current asset to fixed asset and the ratio of the current asset to fixed asset here is say you can say that is 1:1 that out of the total assets or the 1 million rupees that is 10 lakh rupees half of the assets are fixed asset and half of the assets are the current assets.

So if you do like this look at the ROI. ROI is just 15%. Return on investment is just 15%. Then you move to the next level. We increase the we reduce the level of current assets somewhat not much but we reduce the level of current assets. We reduce the level of total assets also and we reduce the level of say current assets.

So it means we are now doing the business not by having total assets of the 1 million or 10 lakh rupees but by having only the say total assets of 9 lakh rupees out of which fixed asset level is same that is 5 lakh rupees but we have been able to reduce the current assets. As I told that the current assets level should be as low as possible. So we reduced the level of current assets. So you see that the ratio has also changed.

The ratio now is that is the 0.8:1 and if you see the column B the last column in the column B the last row that the ratio has now changed come down from the 1:1 to 0.8:1 and when you have reduced the level of current assets your ROI has say gone up that is from 15% to 16.67% and

then you see we are moving to the next level by keeping the lowest level of current assets. Now we have reduced the level of current assets not 5 lakhs not 4 lakhs but we have come down to 3 lakhs.

And now we are running the show with the total amount of the assets that is of 8 lakhs; 5 lakhs are the fixed assets and 3 lakhs are the current assets. So we are not disturbing the fixed assets by keeping the same amount of fixed assets. If you are reducing the level of current assets ratio has also changed. Ratio is now 0.6:1. So it means as against 100% of the current assets in the first policy or in the first column you have reduced it to 60% as compared to the fixed assets.

And you can see the impact of this that your ROI has seriously gone up that is almost by say 3% that is 2.75% it has gone up it has increased which was 15% in the say when the policy A was being followed and the level of current asset was equal to the level of fixed asset. So it came down in the column B and when you changed the policy it became aggressive.

Means you can say this is the kind of a situation of the negative working capital that we have 60% of current assets against the 100% of the current liabilities. So it means we have the negative working capital and we are more aggressive in this case. Ratio has also come down and the impact of that is the on the ROI so it means we can prove it we are convinced now that the level of current assets in any firm should be as low as possible because they are the least productive assets.

Only we should try to maximize the fixed assets and minimize the current assets right. Now we move to the next level and we look it from the other perspective, sources of financing. Sources of financing the assets of the firm, total assets of the firm if you look at.

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Effect of Long-term and Short-term financing

Rs. Lakhs

	Financing Plans		
	Conservative	Moderate	Aggressive
Fixed Assets	3,00,000	3,00,000	3,00,000
Current Assets	2,00,000	2,00,000	2,00,000
Total Assets	5,00,000	5,00,000	5,00,000
Short-term debt (12%)	60,000	1,50,000	3,00,000
Long-term debt (14%)	2,40,000	1,50,000	0
PBIT	90,000	90,000	90,000
Interest	40,800	39,000	36,000
EBT	49,200	51,000	54,000
Tax (35%)	17,220	17,850	18,900
Net income	31,980	33,150	35,100
Return on equity	16.00%	16.58%	17.55%
SF/TF*	12%	30%	60%

And here also I tell you that say your short term finance is cheaper as compared to the long term finance because of the term structure of interest rates. So we should try to have larger amount of the funds. I would not say the maximum funds from the short term sources but the larger component or amount of the funds coming from the short term sources rather than from the long term sources.

Now we will move to the next part that is say next thing that is the means it is one more important concept that till now we have seen that say how the current asset impact the profitability or level of the current assets impact the profitability. Now let us see from the other perspective that is from the financing. So I have been talking to you that short term sources of the funds are lesser expensive as compared to the long term sources of the funds.

And in this case we have to see we have to verify that whether it happens or not. Now for example you see that we have again the situation like the total fixed assets are for 3 lakh rupees and the current assets are for 2 lakh rupees so total assets are 5 lakh rupees right. Now total assets of the 5 lakh rupees how they will be funded. They will be funded we have seen in the first case that is the first approach, conservative approach.

Under the conservative approach we are say providing say out of say 3 lakh rupees which is coming from the debt that is the borrowed capital total is of the 5 lakhs. So 3 lakhs we are

showing here that 3 lakh is coming from the borrowed sources as a debt or as a long term loan or as debentures or anything and remaining is coming from the share capital. So that 3 lakh rupees which is a borrowed capital that is coming in the form of short term debt as well as the long term debt.

And we have assumed here that the cost of the short term debt is 12% and the cost of the long term debt is 14%. So look at the conservative policy the column one, first column or the second column in this case under the financing plans. First is the conservative policy. Under the conservative policy how we rae financing the total asset requirement that is from the borrowed sources 240000 Rs are coming from the long term sources.

And only 16000 is coming from the say short term sources which is just 12% which is just 12% and it is coming from the short term sources as you call it as the ratio of the total finance I am talking about. It is not the ratio of the say long term to short term debt. Total finance that is the 5 lakhs, out of that 5 lakh rupees 16000 that is just 12% is coming from the short term sources and remaining amount is coming from the long term sources including share capital.

So look at the total cost. Profit before interest and taxes 90000 Rs, Interest component is 40800 Rs. Earning before taxes 49200. Tax at the rate of 35% it is 17220 and if you calculate the ROE that is return on equity so it is 16%, it is just 16% because we are only arranging 12% of the total requirement of 5 lakhs from short term sources. Now you move to the moderate plan or the say you can call it as hedging plan.

We have increased the component proportion of the short term finance as against the total requirement and now it is not 60000 it is 150000 Rs. So from the borrowed capital which is a debt component half is coming 50% is coming from the short term sources and 50% is coming from the long term sources.

And if you have seen this change then the impact of this change we have we can easily find out is number one is the ratio of the short term funds to the total funds has gone up by say a sufficient amount that is 18% from 12% to 30% and as a result of that we can see here that your

profit before interest and taxes say 19000. Interest component has gone down seriously that is 39000 and then earning before tax is that is 51000.

Tax is the same amount we are taking tax as 17850 and your return on equity has improved from 16% to 16.58% and in the third approach which is aggressive approach more amount of the funds is coming from the short term sources as against the long term sources and we are so aggressive that you see that the ratio is that that the proportion of short term funds as compared to the total funds, 60% of the funds are coming from the short term sources.

And if you talk about the borrowed capital, borrowed capital in the borrowed capital nothing is coming from the long term sources. Entire amount is coming from the short term sources that is 3 lakh rupees from the short term borrowings and remaining 2 lakhs is coming as a share capital as it was coming under the previous 2 approaches. So borrowed capital is 100% from the short term sources. It being a cheaper source look at your PBTs again.

Profit before interest and tax is again 90000 but look at the interest component which has come down from the 40800 under the first approach which came down to 39000 under the second and it has come down to 36000 under the third approach and as a result of that your net income has improved and net income which was say you can say 31000 around it has it became 33000 and now it has become 35100.

And ROE if you calculate which has gone up by almost 1.55% or no ya 1.55% which was 16% in the first approach rose up to 16.58% and now it is 17.55%. So it means you can easily find out, you can easily verify the impact of the say composition of the funds. If the more funds are coming from the short term sources as compared to the long term sources as far as the borrowed capital is concerned in that case your cost of funds total financial cost is going to seriously go down.

And impact of that is the increased profitability, increased income, and the increased return on the equity because ultimately it is the benefit of the equity share holders for the firm that after servicing the borrowed capital or after providing the debt or paying the interest on the debt on

the borrowed capital remaining amount of the profit or income goes to the equity share holders. So equity share holders are at the benefit.

So they should try to generate maximum funds from short term sources. I would not say maximum but yes as much as possible funds from the short term sources so that the financial cost can be managed but you see the problem of the short term funds is that when you are arranging the funds from the short term sources your financial cost is going to go down but your risk is also increasing.

Because making the payment to the short term sources becomes quickly due so we have to have the sufficient liquidity in the firm so that we can service the short term debt as and when it becomes due to be paid and the interest to be paid on that and finally we can maximize the profitability. That much caution we have to keep. If we are able to keep the caution and to maintain the liquidity in the firm it is always better to have the funds from the short term sources, more funds from the short term sources as compared to the long term sources right.

Now we talk about the certain say cases of certain companies that how they have been managing their working capital. We have the situation of the 3 companies here and these 3 companies belong to the same sector that is the steel sector. In the steel sector you see I told you in the previous classes also sometimes little bit not more that in the steel sector we have number of companies working now in India after 1991.

The steel sector is opened up for the say private participation and many companies have entered in this sector. So if you talk about the companies now means if you compare the say steel sector or the position of the players business players in the steel sector before 1991 SAIL was having the largest market share some part was with the TISCO but SAIL was the steel maker to the nation right.

But after that we have seen that some companies have come in the western part of the country like ESSAR, Lloyd Steels. They have come in the western part. They are serving the western market. In the southern part of the country Jindals created a very high tech Asia's first high tech

plant that is JVSL that is Jindal Vijayanagar Steel Plant which is now called as is now it has become the part of the Jindal Steel Works JSW.

So it means now the SAIL has to say lose market. SAILs overall financial performance has been affected.

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Liquidity Position of SAIL

Year	Current Ratio	Acid Test Ratio
2000 - 01	1.58 : 1	0.71 : 1
2001 - 02	1.45 : 1	0.60 : 1
2002 - 03	1.68 : 1	0.66 : 1
2003 - 04	1.72 : 1	0.79 : 1
2004 - 05	1.55 : 1	0.77 : 1
2005 - 06	1.76 : 1	0.89 : 1
2006 - 07	1.98 : 1	0.89 : 1
2007 - 08	2.19 : 1	0.96 : 1
2008 - 09	2.07 : 1	0.97 : 1
2009 - 10	1.35 : 1	0.59 : 1
2010 - 11	1.35 : 1	0.57 : 1
2011 - 12	1.35 : 1	0.46 : 1

Source: Annual Report of SAIL

And if you see the liquidity how they are managing the liquidity of the firm or how they are managing the working capital here you can see that the current ratio of the SAIL from the, ratios are somewhere from 2001 to 2012 for the past 10 years you can say. So the ratio is very high. Standard norm of the current ratio which was earlier I would say that the norms of the say current ratios have changed.

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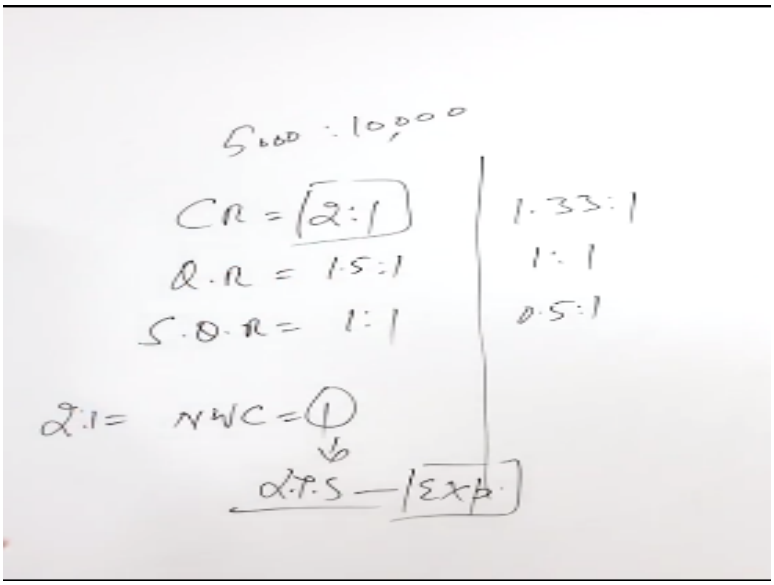

If you talk about the norms of current ratio earlier before 1991 the norms of current ratio was current ratio is that is the norm was 2:1. Then we have the quick ratio or you call it this ratio is the asset ratio also this was 1.5. You can say it was 1.5:1. This now was 1.5:1 and for the cash or the super quick ratio this is the super quick ratio, this is the old norm which was 1:1. This was the these are the old norms.

But now the new norms are like that if you see the norms currently prevailing in the market the proper say you can call it acceptable level of current ratio is 1.33:1. This ratio you consider good is 1:1 and this ratio is considered good as 0.5:1. So these are the new norms of the current ratios. We have reduced the level of say current assets. Now for example when it was 2:1 so what was the situation that we had to keep current assets 100% more than the current liabilities.

Means if you have say current assets if your current liabilities are of the 5000 Rs then you have to have the current assets of the 10000 Rs. So means 100% more than the current liabilities you have to keep the current assets. And I told you that after the term structure of interest rates when you see that this is the current ratio. So current ratio is here. When we are having a current ratio of 2:1 it means net working capital is how much that is 1.

So it means and this net working capital will come from where from the long term sources LTS and long term sources are highly expensive. So if you are increasing the proportion of the long

term sources to finance your short term requirements and that proportion is 100% of your current liabilities then how much funds are coming from the short term spontaneous and short term sources same amount of the funds is coming from the long term sources.

So in that case you can understand how much is going to be the financial cost of the firm. How much expenses are going to increase and how much the financial cost is going to increase. So in that case it was very **very** difficult for the firms to survive in a changed economic scenario where they have to face the competition from the best players in the market.

And their financial cost is so high because now if you are calculating the total cost of the product if you are calculating the total cost of the product, we have the raw material cost. We have the other say overheads cost. We have labour cost. We have some indirect expenses like office expenses, electricity, power, water. All these costs are there. We calculate and add it up and then we have the financial cost.

Till 1991 in India the scenario was that financial cost was not considered as a very important cost. It was not for 1 company, all the companies were following the same norm. Largely, most of the companies were or most of the business sectors in India were controlled by the public sector companies and in the public sector companies something means on the name of financial discipline almost there was nothing.

Easy capital was available from the government. Government was providing the easy capital. Huge country was the market available to them. So whatever is going to be the cost of the production if there is only single player in the market manufacturing the product in the market you have no option to buy the product from any source. In that case whatever the price they want to charge, whatever the cost is there and whatever the price they want to charge you have to pay the price.

No option because the basis of deciding the price is the cost. So if the cost is high so it means the price will also be high keeping their margin intact. So it means everybody was paying the same

price. So that was the case with the SAIL also. SAIL you see the entire steel sector of this country, we were almost 100 crore people 1 billion people at that time or maybe more than that.

And this market of the 1 billion people was being served, steel market for the 1 billion people was being served by only one single company largely. TISCO was also there but large market share was with the SAIL and if you have only 1 company you have no other option. Whatever the garbage they are manufacturing and selling to us and the cost rather the price they are selling it to us we are bound to have it. There is no comparison.

Same was the case with other sectors also. If you talk about the other sectors that was the same case. Say even petroleum sector is even today marketing of the petroleum product is even today dominated by the public sector companies. Now some private sector companies have started coming in the market like ESSAR, Reliance. But it will take time. So thus we are buying the petroleum products at a very high price in the Indian market.

And we are paying for the inefficiencies of these public sector companies. So that was the situation at that time. And because of this we were running the show with this very high current ratio of 2:1 where we are keeping 100% of the funds from the long term sources as a safeguard. This was basically cushion that this cushion should be there that if all the current liabilities if are paid to be paid at one point of time so we will start from the assets current assets.

First we will use the cash. Then we will use the marketable securities. Then we will use the sundry debtors and then we use the inventory and if any of the current assets are not convertible into cash that is the sundry debtors and inventory then the funds will be roped in from the long term sources because we have already kept the current ratio too high that is 2:1. So it means there is no problem and liquidity is always there.

And at the cost of liquidity we are losing something that is the profit because your financial cost is very high. So were having the very high current ratio and since nobody bothers about the cost in this country, bothered at that time so it means there is no question on the cost of the product

that at what cost the product is being manufactured and at what price it is being sold to the people because there was no comparison.

Similarly, the case was with the quick ratio 1.5:1 and so per quick ratio it means you had to keep the cash or almost near cash, liquidity, pure liquidity, and backup liquidity, cash and marketable securities that should be equal to 100% of your current liabilities. So look at the financial indiscipline I would say at that time. So these were the rules of thumbs of the ratios.

And now we have brought down these rules of thumbs to the ratio of these ratios that is from say 2:1 to 1.33:1, 1.5:1 to 1:1 and from 1:1 to 0.5:1. So we have brought down these rules of the thumbs of the liquidity or the liquidity ratios. Why we have done that and what is the benefit we are going to reap out of it that we will discuss in the next class. Thank you very much.