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Dr. Gour Gopal Banik
Associate Professor, Gauhati Commerce College, Guwahati, Assam, India

Jugal Kumar Boro
Assistant Professor, B.H. College, Howly, Barpeta, Assam, India

Corresponding Author:
Dr. Gour Gopal Banik
Associate Professor, Gauhati Commerce College, Guwahati, Assam, India

A study on liquidity and profitability of micro, small and medium enterprises (MSMES) in Assam, India

Dr. Gour Gopal Banik and Jugal Kumar Boro

Abstract
Liquidity and solvency are crucial aspects of every business's success. A business's capacity to manage its liquidity is essential to its success. MSME sector is essential for promoting India's social and economic development. It has been recognized as an essential sector in the creation of employment opportunities, poverty reduction and regional development. MSMEs are therefore vital to the nation's economy's development. In this study, Liquidity condition of MSMEs and the relationship between liquidity position and profitability of MSMEs is examined. Data has been collected from 100 randomly selected registered MSMEs in Kamrup district, Assam (India). The study revealed that the liquidity position of 40% MSMEs is moderate and there exits an inverse relationship profitability and liquidity among MSMEs which is not significant at 5% level. Thus, the conclusion can be drawn from the study that liquidity has no significant impact on MSMEs' profitability. An enterprise should have the ideal level of liquidity. It shouldn't be too little or too much.

Keywords: Liquidity, profitability, MSMEs, economic

Introduction
MSMEs are essential for promoting India's economic development. This sector is recognized as a key factor in employment, income generation, reducing poverty, and regional development in recent years. Effective financial management is important for smooth running of any business enterprise. Profitability, liquidity and solvency are crucial aspects of every business's success. A business's capacity to manage its liquidity is the key to its success. All businesses need to comprehend how crucial it is to manage liquidity as it impacts the profitability, and solvency, of an enterprise. Enterprises should maintain adequate level of liquidity so that they can pay its short-term liabilities. Inadequate liquidity management can hamper the progress of the enterprises and profitability. This may cause of financial instability and insolvency of the enterprises. For any business enterprise, maintaining a balance between liquidity position and profitability is very difficult. As per the risk-return trade-off concept, we would not take on more risk unless we anticipate receiving a higher profitability or higher return on investment. Higher the liquidity, lower the return (profitability) as more assets are blocked in current assets and have minimal risk. Inadequate liquidity might increase profitability, but it may negatively impact an organization's ability to run smoothly.

Classification of MSMEs

Table 1: As on 1st June 2020 MSMEs are defined/classified on basis of composite criteria as given below

Enterprise	Definition	
	Investment limit (in plant and machinery)	Turnover (Annual)
Micro	Not more than 1 crore rupees.	Not more than 5 crore rupees.
Small	Not more than 10 crore rupees.	Not more than 50 crore rupees.
Medium	Not more than 50 crore rupees	Not more than 250 crore rupees.

(**Source:** Ministry of MSME)

Statement of the problems
The capability of an enterprise to manage its liquidity is critical to its success. Every firm needs to recognize how important it is to manage liquidity since it affects an enterprise's sustainability and profitability. Enterprises should have adequate liquidity to pay off their

immediate liabilities; otherwise, they are unable to operate. Inadequate liquidity management may cause financial instability and insolvency and restricting the business's ability to continue growing and generate a profit. Maintaining a stability between liquidity position and the profitability is the most challenging task for every enterprise.

Review of Literature

Eljelly (2004) [1], investigated among joint stock companies of Saudi Arabia to know the relationship between liquidity and profitability of companies. The researcher found that there is a a negative correlation between liquidity and profitability.

Dinku (2013) [8] found that there is a substantial relationship between working capital management and between profitability of the firms. There is a positive correlation between average payment days and profitability of the enterprises are, whereas debtors' turnover period and earning capability of the businesses are negatively correlated.

Jennifer and Dennis (2015) [10] conducted a study in Kenya came and came into the conclusion that the progress of SMEs in Kenya was significantly influenced by financial management. It revealed the importance of techniques for effective financial management among Kenyan SMEs since inefficient financial management leads to poor performance and ultimately cause the failure of SMEs, which has adverse consequences on the economy.

Toran and Solano (2019) [9], conducted a survey on Spanish firms to know the effect of working capital management on the earning capability of small and medium enterprises. They revealed that that there is a negative relation between SMEs profitability and average inventory turnover period and collection period.

Mayanja (2022) [12], examined the relationship between liquidity management among Micro, small and medium enterprises and the profitability by implementing a cross-sectional descriptive design. The researcher revealed that the liquidity management practices of MSMEs were ineffective, negatively impacting the earning capability of MSMEs.

Airout and *et al.* (2023) [2] conducted a study in Jordan and revealed that an insignificant relationship between accounting expenditure and liquidity. According to their research, accounting expenses have a major impact on SMEs' short-term spending, consequently it affects their financial success. Their study indicates that small- and medium-sized enterprises must have ideal liquidity position.

Objectives of the study

1. To analyse the liquidity condition of MSMEs.
2. To know the relationship between liquidity position and profitability of MSMEs.

Hypothesis

H_0: There is no significant relationship between liquidity condition and profitability of MSMEs.

H_1: There is a significant relationship between liquidity condition and profitability MSMEs.

Research methodology

The present study is conducted based on both the primary data and secondary data by adopting descriptive and analytical research approach. To collect the primary data, 100 Micro and small enterprises, which is registered in Kamrup district of Assam, has been selected. Out of which 50 enterprise is micro enterprises and 50 small enterprises. Financial data used in, collected from the website of ministry of corporate affairs (MCA) and from the selected enterprises through structured questionnaire/schedule. Descriptive statistics has been used to analyse the data and to examined the relationship between liquidity and profitability correlation analysis has been applied.

The variables selected for the study are described below:

1. To study the liquidity condition of MSMEs, liquidity ratios: (i) Current ratio, and (ii) Quick ratio; has been selected.
2. To study the relationship between liquidity condition and profitability following variables has been selected.

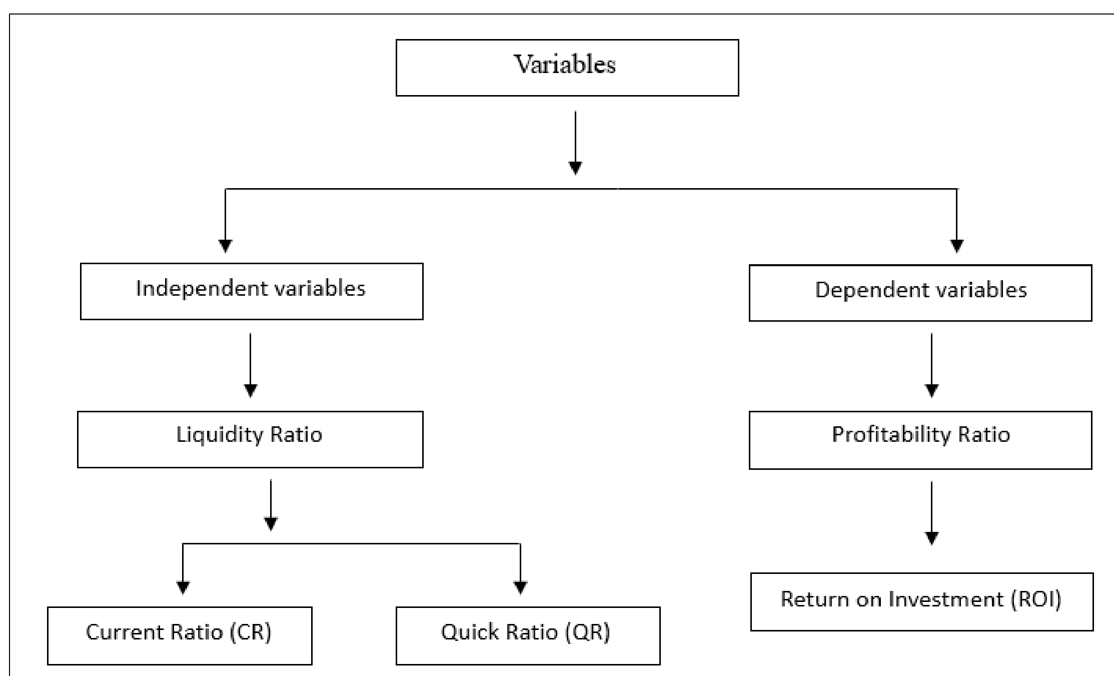

Table 2: Following rating scale has been used to measure the liquidity position of MSMEs

Ratio	Low	Medium	High
Current Ratio	Below 2	2 to 10	Over 10
Quick ratio	Below 1	1 to 5	Over 5

(**Source:** Mendoza, 2015: Financial performance of micro, small and medium enterprises (MSMES) in the Philippines)

1. **Liquidity ratio:** Ability of an enterprises to pay its current liabilities is called liquidity. Cash realized from current assets is utilised to pay short-term commitments. The adequacy of liquid or current assets is critical to a business's existence, and the liquidity position is a main pointer of its capacity to meet up its current debts.
2. **Current Ratio (CR):** The current ratio is a ratio of current liabilities to current assets. This ratio is primarily used to assess a company's liquidity condition. It shows the availability of current asset for each rupee of current obligations. The current ratio assesses the creditworthiness, resource efficiency, and short-term financial strength of the company. Conversely, a lower current ratio implies a greater danger of the company's incapacity to make payments. A higher current ratio implies stronger liquidity. 2:1 is considered as a standard current ratio. Current ratio is calculated by applying the following formula:

$$\text{Current ratio} = \frac{\text{Current Assets}}{\text{Current liabilities}}$$

(ii) Quick Ratio or liquid ratio: This ratio provides a precise evaluation of a company's liquidity. Comparatively less liquid assets, including inventory and advance payments, are not considered in the quick ratio calculation. This ratio is also known as the acid test ratio or the liquid ratio. In general, a quick ratio of 1:1 is considered ideal. It is calculated as under.

$$\text{Quick ratio} = \frac{\text{Quick or Liquid ratio}}{\text{Current liabilities}}$$

Profitability Ratio: Profitability is the capability a firm to earn profit. Profitability ratio reflects the capacity to earn profit of a firm. Profitability ratios are used to determine the overall performance of the business. Usually, it is calculated either in relation to sales or in relation to investment.
Return on Investment: This is the most significant profitability ratio. The primary profitability ratio is another name for it. It implies the return rate on the funds the firm has invested. Thus, this ratio tells us something about how much resource is being used. Return on investment is calculated as given below.

Return on Investment= (Net Profit/Investment) X 100

Limitation of the study

The study covers only micro and small manufacturing enterprises. Moreover, only registered MSMEs are included to collect the primary data.

Data analysis and Findings

Table 3: Current Ratio

Enterprises	Below 2	2 to 10	Over 10
Frequency	37	40	23
Percentage	37%	40%	23%

The current ratio assesses an enterprise's creditworthiness and short-term financial health. As per aforementioned table, most enterprises' (i.e. 40%) current ratios range from 2 to 10 and 37% enterprises' current ratio is less than 2 i.e. lesser than standard ratio. Current ratio of 23% enterprises' is greater than 10 which is considered as very high liquidity position.

Table 4: Quick Ratio

Enterprises	Below 1	1 to 5	Over 5
Frequency	39	40	21
Percentage	39%	40%	21%

A more efficient and extensive way to assess the liquidity of a business is through the quick ratio. The quick ratio of 40% of enterprises is medium (1 to 5), followed by 39% of enterprises' quick ratio being low (below 1), which is lesser than the ideal quick ratio (1:1), and 21% enterprises' quick ratio being high (over 5).

Table 5: Descriptive Statistics

Descriptive Statistics					
Variables	N	Mean		Std. Deviation	Variance
	Statistic	Statistic	Standard Error	Statistic	Statistic
CR	100	7.97995	1.2374045	12.3740451	153.116992
QR	100	4.39885	0.980895735	9.80895735	96.2156444
ROI	100	10.882	1.51985322	15.1985322	230.995382

In the aforementioned table descriptive statistics of the selected variables- mean, Standard deviation and variance is presented. It is seen from the above table that the mean of return on investment (ROI) is 10.882. The mean of current ratio and quick ratio are 7.97995 and4.39885 respectively, which is larger than standard ratio (CR-2:1 & QR-1:1).

Table 6: Correlation Matrix

Correlations		CR	QR	ROI
CR	Pearson Correlation	1	.911*	-.015
	Sig. (2-tailed)		.000	.879
	N	100	100	100
QR	Pearson Correlation	.911*	1	-.012
	Sig. (2-tailed)	.000		.910
	N	100	100	100
ROI	Pearson Correlation	-.015	-.012	1
	Sig. (2-tailed)	.879	.910	
	N	100	100	100
*. Correlation is significant at the 0.01 level (2-tailed).				

Pearson Correlation matrix is calculated to study the relation between Liquidity condition and Profitability. The aforementioned tables illustrate the relations between liquidity variable (CR &QR) and profitability variables (Return on Investment). As seen in the above table, there exist opposite relationship between current ratio and return on investment which is not significant at 5% significance level {(p=.879)>0.05)}. Moreover, correlation between quick ratio (QR) and return on investment (ROI) (r=-0.012)

is negative which is not significant sig (p=0.910>0.05. Hence, the null hypothesis accepted, as the liquidity has no significant correlation with profitability.

Conclusion

In the present study it is found that large number of MSMEs (i.e. in CR-23% and QR-21%)'s liquidity position is high, and some MSMEs' liquidity position is lesser than the standard (i.e. in CR-37% and QR-39). It reveals that the relationship between the liquidity position of MSMEs and profitability of MSMEs is insignificant. Liquidity variables are inversely correlated to profitability variables, but insignificant at the 0.05 level. Thus, it can be concluded that there is no significant impact of liquidity on profitability. An enterprise should have the optimum level of liquidity. It shouldn't be too little or too much. Inadequate liquidity can result in a halt to corporate activities, while excessive liquidity implies retaining additional funds in current assets, which could reduce profitability. Hence, management should consider liquidity management as well as other managerial factors to improve profitability.

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