

# Working Capital Management and Its Impact on Liquidity and Profitability: A Study of Hotel Industry

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## Abstract

Working Capital Management (WCM) is a fundamental element of financial management that governs the operational efficiency and financial sustainability of firms. In the hotel industry, WCM assumes even greater significance owing to unique challenges such as seasonality, perishability of inventory, credit-based transactions, and high operational costs. This study investigates the impact of working capital management on the liquidity and profitability of Lemon Tree Hotels for the period 2021–2025. Using secondary data from audited financial statements and employing ratio analysis, trend analysis, correlation analysis, and descriptive analysis, the study evaluates the behaviour of current assets and current liabilities and their effects on key financial indicators. Findings reveal that despite negative working capital emerging post-2022, the company demonstrated a significant improvement in profitability. Receivables and payables management emerged as the most influential components of working capital performance. The study concludes that effective working capital practices are essential for maintaining liquidity and enhancing profitability, particularly in the dynamic and competitive hospitality sector.

**Keywords:** *Working Capital Management, Liquidity, Profitability, Hotel Industry, Cash Conversion Cycle, Lemon Tree Hotels*

## I. Introduction

Working Capital Management (WCM) forms a core part of financial management and plays a crucial role in the successful functioning of any business enterprise. It focuses on maintaining the optimal balance between current assets and current liabilities to ensure operational efficiency and financial stability. Working capital decisions determine a firm's ability to meet short-term obligations, manage daily operations smoothly, and maintain adequate liquidity.

In the hospitality sector—especially the hotel industry—working capital management is even more vital due to unique operational characteristics such as seasonality, high fixed and variable costs, perishability of inventory, and continuous service delivery requirements. Hotels need to maintain the right level of inventory, manage cash flows effectively, control receivables, and ensure timely payments to suppliers. Therefore, the broad area of this study deals with understanding how working capital policies and practices impact the liquidity and profitability of hotel businesses.

The hotel industry is one of the fastest-growing sectors within the service economy, contributing significantly to tourism, employment generation, and economic development. Hotels must continuously invest in service quality, maintenance, inventory, staff salaries, utilities, and guest experiences. Unlike manufacturing companies, hotels produce and consume services simultaneously—a room not sold today cannot be stored and sold tomorrow. Similarly, food and beverage inventory is highly perishable. These characteristics make the management of working capital in hotels complex yet crucial.

### A. Key Scenarios in Working Capital for Hotels

Several scenarios demonstrate the importance of working capital in the hotel industry:

- **Seasonality and Fluctuating Occupancy Rates:** Hotels experience seasonal demand based on tourism seasons, festivals, and business travel cycles. During off-seasons, revenue declines while operational expenses remain constant, making efficient WCM critical for survival.
- **High Cost of Operations:** Hotels incur heavy operational expenses covering staff salaries, restaurant and housekeeping inventory, laundry, maintenance, utilities, reservation systems, and outsourced services, all requiring constant cash availability.
- **Credit Sales and Delayed Receivables:** Corporate clients and online travel platforms often book on credit terms with payment delayed 30–45 days or more, creating liquidity pressure and forcing hotels to borrow or delay payments.
- **Inventory Management Challenges:** Hotels maintain perishable items, semi-perishable items, liquor, beverages, and maintenance materials. Overstocking leads to spoilage while understocking affects guest services.

- **Increased Competition and Dynamic Pricing:** The rise of platforms such as OYO, Airbnb, and online travel agencies has led hotels to implement heavy discounts and promotional offers, reducing immediate cash inflow and creating liquidity challenges.

## **II. Statement of the Problem**

The hotel industry continually faces challenges stemming from financial instability and poor liquidity management. One of the most critical areas contributing to this instability is inefficient working capital management. Hotels must maintain adequate liquidity to meet expenses such as salaries, utilities, supplier payments, guest amenities, and emergency operational needs. However, intense competition, seasonality, and economic uncertainty often lead to cash shortages.

Poor receivables management increases the average collection period, tying up funds that could otherwise be used for operations. Similarly, poorly controlled inventory leads to wastage, obsolescence, and increased holding costs. Failure to negotiate favourable credit terms with suppliers also creates a mismatch between cash inflows and outflows, collectively disrupting liquidity and negatively impacting profitability.

Many hotel managers prioritize short-term survival over long-term financial stability, resulting in haphazard financial controls, lack of proper forecasting, and absence of effective monitoring systems for working capital cycles. In severe cases, persistent liquidity problems can lead to insolvency, shutdowns, or the inability to cope with unexpected financial shocks such as pandemics or economic downturns. Given these concerns, there is a pressing need to study the relationship between working capital management and hotel liquidity and profitability.

### **A. Research Objectives**

- To analyse the relationship between working capital management components and the liquidity position of hotels.
- To examine the level of working capital management practices in hotels.
- To evaluate the impact of inventory, receivables, payables, and cash management on hotel liquidity.
- To assess how working capital influences profitability using financial ratios.

### **B. Hypotheses**

**H<sub>0</sub>:** There is a significant relationship between working capital management and hotel liquidity and profitability.

**H<sub>1</sub>:** There is no significant impact of working capital management on hotel profitability.

## **III. Review of Literature**

The body of literature on Working Capital Management (WCM) reflects growing scholarly interest in understanding its role in firm performance, particularly in the service sector.

Shin and Soenen (1998) introduced the concept that the Cash Conversion Cycle (CCC) is the heartbeat of working capital, establishing that shortening this cycle by quickly converting investments in inventory and receivables back into cash improves profitability. Deloof (2003) deepened this understanding by demonstrating that receivables, inventory, and payables are the key organs of this system; when cash becomes stuck in unpaid bills or excess inventory, firm liquidity weakens.

Singh and Kumar (2014) shifted focus to inventory turnover, particularly critical in hotels dealing with perishable goods, showing that maintaining right inventory levels avoids wastage and improves profitability. Pike and Cheng (2001) highlighted that efficient receivable management directly supports liquidity, while Gill, Biger, and Mathur (2010) found that extending payments to suppliers can temporarily increase cash on hand, although stretching payables too far damages supplier relationships.

Afza and Nazir (2008) described the eternal tension between profitability and liquidity, showing that aggressive strategies—collecting receivables quickly and holding smaller inventories—boost profits but risk liquidity shortages, while conservative strategies improve liquidity but lower profitability. Baccini and Urban (2018) highlighted the impact of seasonality, confirming that during low seasons, efficient working capital management can be the difference between survival and financial struggle.

Napo Pech (2012) confirmed that the CCC is a powerful predictor of hotel profitability, while Cheng and Lu (2019) showed how digital billing systems, automated inventory control, and real-time financial tracking transform WCM from a routine task into a strategic advantage. Padachi (2006) tied all elements together by proving that efficient WCM enhances overall financial performance, including ROA and ROE.

### **A. Conceptual Framework**

The proposed conceptual model examines the relationship between working capital components and hotel financial performance. Independent variables include inventory conversion period, receivable collection period, payables deferral period, cash conversion cycle, and cash and bank balances. The model flow is:

*Working Capital Components* → *Liquidity* → *Profitability* → *Hotel Financial Performance*

This model assumes that efficient working capital improves liquidity, which subsequently enhances profitability.

## IV. Research Methodology

### A. Research Design

This study adopts a descriptive research design to examine how working capital management affects the liquidity and profitability of Lemon Tree Hotels for the period 2021–2025. The design focuses on reviewing cash balances and cash management practices, inventory levels and turnover cycle, receivable and payable patterns, cash conversion cycle, liquidity ratios (current ratio, quick ratio), and profitability indicators (GOP, ROA, net margin).

### B. Data Collection

The study is based on secondary data collected from audited financial statements of Lemon Tree Hotels. Sources include balance sheets, profit and loss accounts, cash flow statements, working capital statements, inventory registers, accounts receivable and payable records, and internal management reports. Additional secondary sources include Ministry of Tourism data and published research articles.

### C. Data Analysis Tools

The following financial and statistical tools were employed:

- Ratio Analysis: Current Ratio, Quick Ratio, Inventory Turnover, Cash Conversion Cycle
- Trend Analysis: Year-wise performance of the hotel from 2021 to 2025
- Comparative Analysis: Comparing the hotel's performance across years
- Correlation Analysis: Examining the relationship between working capital and liquidity
- Regression Analysis: Assessing the impact of working capital on profitability

Software applications including MS Excel for tables, graphs, and ratio calculations, and SPSS for correlation and regression analysis, were used for data processing.

### D. Variables of the Study

Working capital variables: Current Assets, Current Liabilities, Inventory Levels, Receivable Days, Payable Days, and Cash Conversion Cycle. Liquidity variables: Current Ratio, Quick Ratio, and Cash Balance. Profitability variables: Gross Operating Profit, Net Profit Margin, and Return on Assets (ROA).

## V. Data Analysis and Interpretation

This section presents the analysis and interpretation of data related to working capital management and financial performance of Lemon Tree Hotels for 2021–2025.

### A. Objective 1: Liquidity Analysis

Table I presents the Current Ratio trend for Lemon Tree Hotels. A declining trend is observed from 2021 to 2025, indicating a weakening short-term liquidity position.

**TABLE I: Current Ratio (2021–2025)**

Year	Current Ratio
2021	1.40
2022	1.00
2023	0.80
2024	0.73
2025	0.62

**TABLE II: Quick Ratio (2021–2025)**

Year	Quick Ratio
2021	1.38
2022	0.97
2023	0.78
2024	0.71
2025	0.60

**TABLE III: Working Capital Turnover Ratio (2021–2025)**

Year	Revenue (₹ Cr)	Working Capital (₹ Cr)	WC Turnover Ratio
2021	83.94	41.29	2.03
2022	132.17	0.08	Very High
2023	310.90	-25.58	Negative
2024	368.79	-30.59	Negative
2025	391.12	-44.68	Negative

The analysis indicates that while the current ratio and quick ratio declined consistently from 2021 to 2025, the working capital turnover ratio reflects efficient utilization of available resources. Working capital became negative after 2022, indicating that current liabilities exceeded current assets, which reflects strategic reliance on short-term payables to fund operations rather than maintaining idle current assets.

## B. Objective 2: Correlation Between Working Capital and Profitability

**TABLE IV: Correlation Interpretation — Working Capital vs Profitability**

Year	Working Capital Status	Profitability Position	Relationship
2021	Positive (41.29 Cr)	Net Loss	Weak
2022	Near Zero (0.08 Cr)	Reduced Loss	Improving
2023	Negative (-25.58 Cr)	Net Profit	Strong Positive
2024	Negative (-30.59 Cr)	Higher Profit	Strong Positive
2025	Negative (-44.68 Cr)	Strong Profit	Strong Positive

The correlation analysis reveals a complex but ultimately positive relationship between working capital management and profitability. Despite the working capital turning negative, profitability improved markedly from 2023 onwards. This suggests that efficient utilization of resources, better financial planning, and improved revenue generation contributed to increased profits, indicating that effective management practices play a crucial role in performance even under liquidity constraints.

## C. Objective 3: Descriptive Analysis of Working Capital Components

**TABLE V: Working Capital Component Analysis (2021–2025)**

Year	Receivables	Inventory	Payables	CCC Trend
2021	High	Low	High	Long
2022	Moderate	Low	Moderate	Improving
2023	High	Low	High	Balanced
2024	Low	Low	Moderate	Short
2025	Moderate	Low	Low	Efficient

**TABLE VI: Component-wise Impact Summary**

Component	Value Trend	Impact on Performance
Cash	Decreasing	Medium

Receivables	Fluctuating	High
Inventory	Consistently Low	Low
Payables	Decreasing	High

Receivables and payables are the most influential working capital components in Lemon Tree Hotels. Inventory has minimal impact, consistent with the hotel industry where inventory is kept lean. Cash flow improved after 2023, driven by better collection practices and revenue growth.

## VI. Findings

The analysis of working capital management of Lemon Tree Hotels for the period 2021–2025 reveals the following important findings:

- Working capital management showed significant changes after 2022. Although the company experienced negative working capital in later years, it reflects a strategic shift in managing current assets and liabilities more efficiently rather than a financial deterioration.
- Profitability increased considerably with improved cash flow management. The company moved from a net loss position in 2021 and 2022 to a strong profit position from 2023 onwards, highlighting better operational efficiency and cost control.
- A strong positive relationship exists between working capital management and profitability. Even with negative working capital, efficient utilization of resources and better financial planning contributed to increased profits.
- The liquidity position showed mixed trends. While traditional liquidity ratios declined, the company maintained smooth operations by relying on efficient cash management and faster turnover rather than holding excess current assets.
- Receivables and cash management are the key drivers of performance in the hotel industry. Inventory played a relatively minor role, while payables management also contributed to maintaining liquidity.

## VII. Conclusion

The study on working capital management of Lemon Tree Hotels for the period 2021–2025 provides valuable insights into the financial performance and operational efficiency of the company. The analysis reveals that working capital plays a crucial role in determining both liquidity and profitability in the hotel industry.

Despite the negative working capital emerging after 2022, the company showed a significant improvement in profitability from 2023 onwards. Revenue increased steadily and net profit turned positive and continued to grow, indicating that the company efficiently utilized its resources and managed operations effectively, even under liquidity pressure.

The correlation analysis highlights a positive relationship between working capital management and profitability. Improved operational efficiency, higher revenue generation, and effective cost control contributed to increased profitability even when conventional liquidity ratios were below optimal levels.

The descriptive analysis confirms that receivables and payables are the most influential components affecting the company's performance. Efficient management of these components helped maintain cash flow and support business operations, while inventory had a relatively lower impact given the asset-light approach of hotel inventory management.

Overall, the study concludes that while Lemon Tree Hotels faced challenges in maintaining adequate working capital, it successfully improved its profitability through efficient management practices. For long-term financial stability, the company should focus on improving its liquidity position by balancing current assets and liabilities. Effective working capital management is essential not only for maintaining liquidity but also for enhancing profitability and ensuring sustainable growth.

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