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# EFFECTIVE MEASURES IN MANAGING WORKING CAPITAL COMPONENTS TO PROSPER ENTREPRENEURS: A STUDY

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## ABSTRACT

*Management of working capital effectively drives the part of the business either towards success or failure of the organisation in the short or the long run because it determines the profitability and the liquidity aspect of the business. The success of any organisation depends upon the handling of working capital by the manager and in my case entrepreneurs who effectively manages the components of the working capital which includes cash, debtors, creditors and inventory as it is very important from the point of view of the organisation to manage a balance between profitability and liquidity while carrying out the day-to-day operation. Working capital reflects a firms' ability to meet day-to-day operating expenses and also acts as an indicator of a firm's short-term financial health. So a firm has to plan the effective utilisation of its working capital in order to maintain equilibrium between liquidity and profitability of the business.*

***KEYWORDS***: *Working Capital Management, Components of Working Capital, Liquidity, Profitability.*

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## Introduction

In day-to-day business operation decisions are mainly based on guaranteed cash flows which facilitate proper allocation of available resources to ensure operations are carried out effectively and efficiently to check sustainability of business. The management of business should be effective and efficient so that it should increase the amount of cash flows. The manager of the business can adopt either of the two aggressive or conservative working capital management strategies is after keeping in mind the goals and the vision of the business with proper study of the situation/state of the organization to manage the components of working capital. The same idea is supported by the agency theory which describes the firms in modern scenario in such a way that the agent and principal are not same parties who should be compelled by interest that is not the situation in most of the modern firms (Bowie and Freeman, 1992).

When the business operation is growing it is very essential for the business to set controls and measures to check, compare between the actual and the projected figures of the organisation. This same thing is supported by the management control theory which explains that there is a need to keep an eye on the control agent operation and action of the management before taking any action (Smith & Bertozzi, 1998). Most of the businesses put more focus on liquidity aspect at the expense of the profitability one. It is liquidity which is defined as a condition where a business unit or a company which is able to meet the obligations of short-term in nature when they become due with or without challenges. Sometimes entrepreneurs fail to analyse the risk return trade off that is expected after alternative implementation of policies of working capital management. Therefore it is very important from the point of view of the business you need to understand liquidity and profitability trade off when great effort are to be made to maximize shareholder value.

The word 'Working Capital' means the funds which is necessary for carrying out day-to-day operations of the business unit effectively. Each and every working business needs working capital. Working capital is a financial metric which depicts operating liquidity which is available for a business for that particular frame of time. The entrepreneur or manager of a unit should determine the net working

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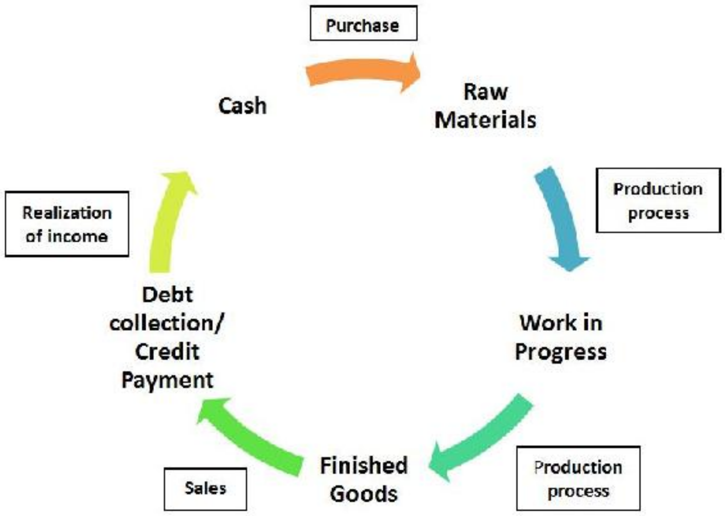
capital by factoring major element in the working capital cycle which includes cash receivable, inventory and the payable. Thus proper management of the current assets and current liabilities of an organisation is needed and from here the concept of Working Capital Management is generated.

**Working Capital Cycle**

Working capital cycle is also known as cash cycle or operating cycle. It is the time frame for conversion of cash into cash equivalent like raw material, work-in-process (WIP), finished goods and after that back into its cash form.




Operating Cycle of a Business

Working capital should not be too long for a business otherwise capital is tied up in working capital which does not bring returns into business. Prospering business requires cash and being able to free up cash and shortening the working capital cycle is the easiest way to grow a business. Nowadays business houses shorten their working capital by reducing its credit period to its customer, by giving cash discount, streamlining production process, increasing sales and negotiating for better credit period from creditors and suppliers in today's world of international competitors a business can operate effectively and efficiently by positive working capital cycle which balances cash inflows and cash outflows so that net working capital cycles gets reduced and thus maximizes to free cash flow.

**Working Capital Components Management Decision**

**Management of Accounts Receivables**

Whenever a firm makes an ordinary sale of goods or services and does not receive cash for it immediately, the firm is said to have granted trade credit to customers. Receivable management is also called as trade credit management. Receivables include-

- Sundry debtors.
- Notes and bills.
- Accrued receivables.

It is very important for businessmen to analyse to know who owns the money, how much it owed, how long it will take to be paid and what was the reason behind that. This helps to avoid the future situations that may cause loss or increased bad debt to the organisation. Receivable management is concerned with the planning and execution of right and appropriate credit policies which include-

- Credit standards.
- Defining credit terms.
- Credit and collection standards.

Data management emphasizes mainly on decreasing the time gap between sales completion and collection of the receivables. A businessman can adopt some measures as mentioned below so that it can ensure fast collection-

- To encourage customers to pay through discount or price reduction.
- Issuing sales invoices to customer without unnecessary delay.
- Providing statement of outstanding amount of customers frequently.
- Implementation of a stricter credit checks to the new customers of the business
- It's very important to review customers' credit limit and specifically the new customers.
- Penalty should be imposed for delay in payment.
- Constant communication should be maintained with the customers (credit).

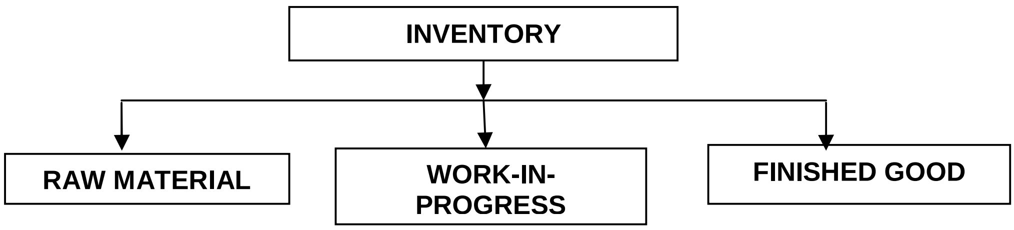
**Management of Accounts Payables**

Accounts Payables result when goods are purchased on credit. The management of accounts payable are all set policies, procedures and practices used by a business unit to manage its credit purchase. The management and monitoring of time factors and amount to be paid should be very precise in order to maintain good relationship with the suppliers (credit). The main motive behind the management of payable is to negotiate for favourable credit terms with creditors and suppliers. The measure can be adopted to manage creditors and suppliers are-

- Managing floor and the timing of purchases.
- Monitoring the due date of credits.
- Communication with suppliers (so that payment and its reconciliation are up-to-date).
- Examining the business credit limit.
- Acquiring favourable terms of purchase.
- Monitoring proper record for all the purchases made on credit basis.

**Management of Business Inventories**

Inventory is the list of all the raw material work-in-progress or finished goods which undergoes production process or to be sold to customers. Inventory management affects the average number of days of inventory is being held by the business. Effective management of inventory is very essential and if not properly managed it can increase the storage cost of the inventory as well as the capital of the organisation will get blocked into the inventory which might lead to missing of opportunities. Both excessive and insufficient stocks are very dangerous from the point of view of the organisation. Excessive stock can lead to capital blockage while insufficient stock can lead to the dissatisfaction among customer and also can cause missing opportunities to the organisation. Stocks are classified as under:




The main idea to manage inventory is to identify the optimal level of stock that should be there for the future without blockage of capital. The measures which can an enterprise adopt so as to manage inventory are:

- Ascertainment of estimated future sales for each of the product.
- Determining the availability of raw materials.
- Identification of external market factors which can influence business cycle.
- Determining the delivery period of each suppliers so as to choose the best one.
- Calculating the stock turnover period for stock of the business.
- Minimising of the waste or damage should be promoted.
- Selling of out-dated/old stock at cost (so as to freeing-up of blocked capital).

**Management of Business Cash**

Rightly is the saying, cash is the lifeblood of all the business which in today's competitive word determine the survival and prosperity of the business. Management of cash essentially deals with the managing of the liquid cash and the near cash asset which can be converted into cash when and where required due to time by the business. Managing of cash is a broader term which includes from the collection, concentration and payment of cash. Management of cash identifies the right amount of cash which is required by the organisation to carry out its day-to-day work without any hassle and at minimal holding cost. Optimal cash balance of an organisation involves maximizing the availability of cash which is not invested either on the non-current asset or the inventory by this it minimises the risk of being in insolvent. Effective management of cash is very important whether you are well established or just a start-up. Some of the measures of management of cash includes:-

- Ensuring the availability of right amount of cash required at the right cost at the right time to meet the obligatory cash outflow.
- Determination of optimal cash balance of a business unit.
- Controlling and monitoring of cash disbursement.
- Establishing good relationship with the cash lender.


**Conclusion**

Working capital is one of the main aspect of the operational efficiency of a business unit it also plays a very important role in the functioning of a business unit it is not only the current asset or the current liability but both are very much influencing factors which crafts the working capital of a business so from the point of view of my paper if proper an efficient check is given on the account receivable, account payable, inventories and cash an entrepreneur can run a business quite smoothly.

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