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WORKING CAPITAL MANAGEMENT: WITH SPECIAL REFERENCE TO CURRENT INDIAN BUSINESS SCENARIO

Devesh Pal*

ABSTRACT

Organisation needs capital for meeting the short-term investment purpose which is required for day-to-day business operations. A type of capital that invests in short-term investments has a high quality and low risk. The objective of this type of capital is to protect the organisation's finance with low level of risk in investment. Short-term assets investment can be made in cash, inventory, debtors, etc., this is termed as short-term funds or working capital. Thus, proper management of the current assets and the current liabilities of an organisation are needed, by this the concept of working capital management comes into existence. In a nutshell we can say that organisation short financing are referred to as working capital management. With this objective my paper presents the balance sheet concept, operating cycle concept and the factors determining working capital needs of organisation established in India.

KEYWORDS: *Working Capital, Balance Sheet Concept, Operating Cycle Concept, Cash Conversion Cycle.*

Introduction

It has been observed all over the world and India is not a exception to this, that the shortage of working capital leads to the failure of an organisation. The proper management and control of working capital of an organisation may result in success of that business unit. When it comes to management of working capital, it includes the management of current assets and current liabilities. A number of business units for the past few years have been finding very difficult to solve the growing problem of adopting itself with the serious issues of managing working capital in India.

An organisation may exist without making profit or even it can run at loss for some time but the business cannot survive without liquidity. And if we compare working capital to that of human organ, so one can say that it is the heart of a business unit. It is also an important function of financial management. The finance manager of a business house should determine well in advance the satisfactory level of working capital funds, and he should also determine the optimum mix of current assets and current liabilities because those (current assets and current liabilities) will have a favourable or unfavourable effect on the organisation according to its way of managing.

* Guest Lecturer, Department of Commerce, Allahabad Degree College, University of Allahabad, Prayagraj, U.P., India.

The finance manager also must ensure that there should be appropriate sources of funds so that it can be used to finance the working capital. It is also upon him to check the short-term obligations of the organisation, is met well in due course.

The management of working capital involves the management of inventory, bills receivables cash and bills payables. Working capital is divided into two parts-

- Gross Working Capital.
- Net Working Capital.

Working capital is the money which is used by the organisation to produce goods and attract the sales. The lesser the amount of working capital used to attract the sales the higher is likely the case to be the return on investment made by the organisation and in my case the organisations of India.

The greater the percentage of funds which is obtained from short-term funds, the more aggressive is the policy or is very risky for the organisation's working capital policy and reverse is the case if conservation policy is opted.

The interpretation of working capital is divided into two parts:

- Balance Sheet Concept.
- Operating Cycle Concept.

Balance Sheet Concept

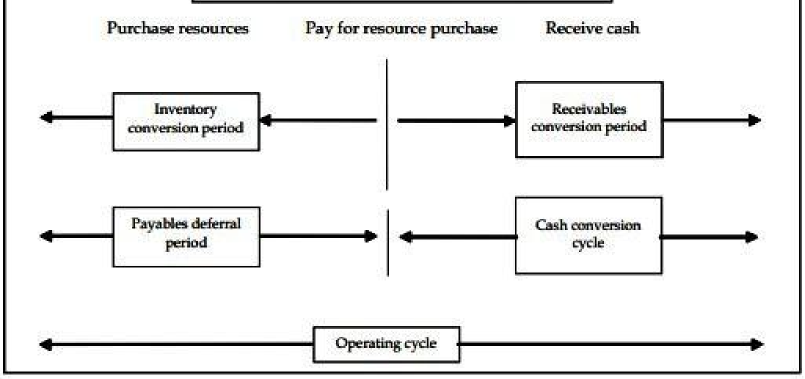
There are two interpretation of working capital under this concept. And the balance sheet concept is represented by the excess of the current assets over the current liabilities of that organisation and this is the amount which is normally available to finance current operations. Economist like Mead, Baket, Malott, etc feel that current assets should be considered as working capital as a whole of the organisation and in my case organisations in India, which helps to earn profits, the management of any organisation is more considered with the total funds that are available for operational purpose by the business units. While some of the economist like Lincoln and Salvers have a different view of this-

- They said that in the long run, what is more to matter to a business unit is the surplus of current assets over the current liabilities for that particular time frame.
- They also emphasis that it is the concept which helps the creditors and investors of the organisation to judge the financial adequacy of the business unit.
- It is the excess of current assets over the current liabilities which should be relied upon to meet the contingencies.
- Working capital is a part of the long-term finance which is locked up in an organisation and is used for supporting current activities. Thus we can say that, the larger the amount of working capital, the greater should be the proportion of the long-term capital sources taped to short-term activities.

Operating Cycle Concept

An organisation's operating cycle starts from purchasing of resources, producing the product and it ends on after selling the product. These above activities of a business unit in India create fund flows that are both unsynchronized and uncertain. Unsynchronized in the sense, cash disbursements usually take place before the receipt of cash. And uncertain in the sense, as the future sales and cost which is generated by the above respective receipts and disbursements, but it cannot be estimated with greater level of accuracy. The organisation is to maintain a cash balance to pay-off the bills as and when they become due. In addition to this, the business unit must also have to invest in the inventories of the business to suit consumer orders promptly. And finally the business house invests in accounts receivable to extend credit to its customers.

Figure 1.1: Operating Cycle of Typical Company



Operating Cycle = Inventory Conversion Period + Receivable Conversion Period

Operating cycle of a trading company consists of:

- Cash which is invested in inventories.
- Inventories into accounts receivable.
- Accounts receivable which is there into cash.

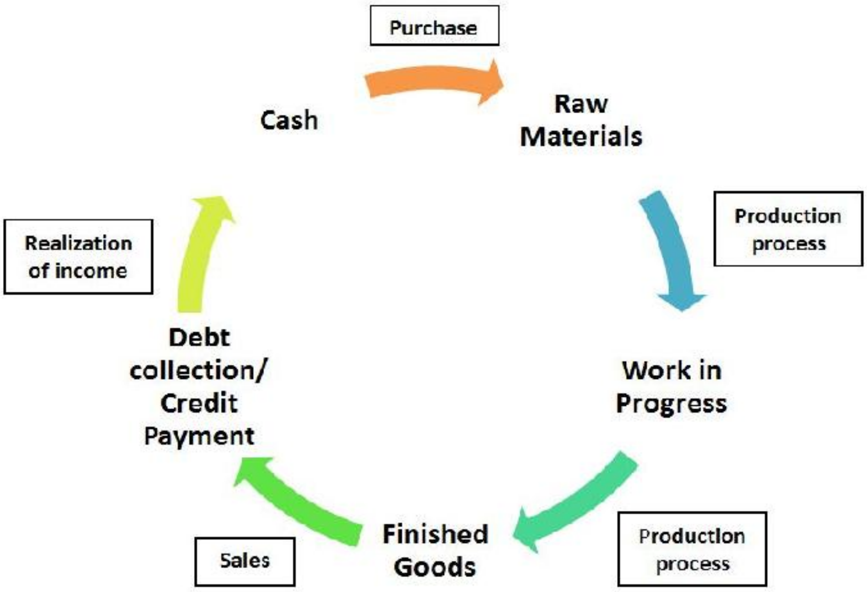
Before completing the operation cycle concept let us see one more important heading which is cash conversion cycle. The cash conversion cycle represents the net of the time gap from the collection of the cash receipts by selling the product to the customer, to the cash payments for the company's various resources purchased.

Cash Conversion Cycle = Operating Cycle - Payable Deferral Period

The cash conversion cycle represents the time gap over which there will be no additional sudden growth of sources of working capital financing should be obtained to carry out the activities of the business unit and in my case the business units established in India. If there is an increase in the length of the operating cycle of the organisation without a proportionate increase in the payable deferral period, this will lengthens the cash conversion cycle and thus by that it will create further working capital financing requirement for the business unit.

Factors Determining Working Capital Needs

- **Business Cycle-** Cyclical changes in the Indian economy may influence the quantum of working capital which is needed by the organisation for a particular time frame. In the period of boom during business life cycle, when the business is prosperous there is a larger of working capital requirement, due to the rising sales there will be rise in prices of the product of the business unit, and when the business is going through depression the reverse of the above will be noticed i.e., less working capital will be required.
- **Manufacturing cycle-** It is the length of the manufacturing cycle which influences the quantum of working capital which should be needed by the organisation. In simple words, the longer the period for conversion of inventories into cash, the larger the amount will be required by the organisation as working capital and vice-versa when the situation gets reverse of this. Manufacturing process always requires time gap from the time when raw material gets into the unit to undergo production process to become work-in-process (WIP) to this WIP again undergo production to become finished product. It is the product and the production technique which also determine the time gap between the start of the process and the ending of that particular process. For example, if the organisation is using capital intensive technique then the time period will be reduced in comparison to labour intensive technique, in most of the cases. And same is the case with the product, when small product is produced it will take less time period than in comparison to large and complex goods being produced. Thus, by this we can conclude that shorter the manufacturing cycle the lesser the working capital will be required by the organisation.



Operating Cycle of a Business

- **Market Conditions-** The level of competition which is pertaining in the market place has an important bearing on the working capital need of a business unit in India. When competition is keen and the customer is willing to purchase without any delay in time, a larger inventory of finished goods is required and because of this larger amount of working capital will be used for this opportunity to meet. And if that business unit does not meet the working capital requirement, then the output (inventory) so desired will not be met (inventory) and as a result the customers may switch to some other competitors available in the India market.
- **Dividend Policy-** Dividend has a dominant influence on the organisation's position of working capital. If the organisation is giving the majority part of the earning per capital (EPS) as dividend to the shareholders then the organisation will left with minor part of EPS for it development and for its use when and where needed. This is known as aggressive dividend policy. But when the organisation is following a conservative dividend policy, i.e. the organisation will keep majority part of the EPS as retaining earning for the organisational development and at this point the organisation will have ample amount as working capital and minor part is distributed to the shareholders as dividend. So it is clear by above that larger the working capital cycle the more is the requirement of the working capital by the business unit.
- **Seasonality of Operations-** Those organisations which have increase in production only for certain time frame (like-woollen industry) in the winters and sharp drop in production in the summer months have highly fluctuating working capital requirement because in that particular season there business tends to rely and prosper. Thus, the working capital requirement of such organisations is likely to increase in winter and decreases significantly during summer season.
- **Change in Technology-** Upgradation of technology may lead to improvement in the production process of the business unit. When the raw materials which undergoes production process with upgraded technology become work-in-progress, then this work-in-progress again undergoes production process to become finished product, then the output so produced will be of great quality and there will be less wastage of resources, greater productivity and finally due to this latest technology of production will also get speed-up. All these improvements may help the firm to reduce its investments in inventory and as a result the working capital requirement will get reduced.

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. The basic goal of working capital management is to ensure the day-to-day business activities of an organisation get satisfied and also the maturing short-term debt and future operational expenses of an organisation meet its situation accordingly. This is very important for a manager of an organisation to manage the funds by estimating the future obligations.

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