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ANALYSIS OF WORKING CAPITAL MANAGEMENT IN CURRENT BUSINESS SCENARIO: A STUDY

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ABSTRACT

Working Capital is a financial metric which represent the amount required by the organisation for day-to-day business operations efficiently. It is required by every business organisation whether big or small. The working capital represents the operating liquidity of a business unit. An organisation can provide with its assets and profitability but sometimes may fall short of liquidity if the assets of the organisation cannot be readily converted into cash. Positive working capital is vital to ensure that an organisation is able to continue the operations and it also has sufficient funds to satisfy both the short-term debt those are maturing as well as the future operational expenses. 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 factors determining working capital needs with reference to working capital based on concept and time factor.

Keywords: *Working Capital, Gross Working Capital, Net Working Capital, Permanent Working Capital, Temporary Working Capital.*

Introduction

Working capital management takes into consideration the relationship between a firm's assets and liabilities which are short-term in nature. The goal of working capital management is to ensure that the organisation is able to meet the continuity of the operations and it has sufficient resources to satisfy both the maturing debt (short-term in nature) and future operational expenses. The management of working capital involves management of inventory, bills receivables, bills payables and cash. Working Capital is also that part of money which is used to make goods and attract sales. The lesser the working capital used to get the sales, the higher will be the return on investment. Working capital Management is about the commercial side as well as the financial side of the inventory, credit, purchasing, investment policy and marketing. The most liquid and vital asset of any business organisation is cash. The management of cash efficiency is very crucial when it comes to the solvency in the business because it is cash which is the focal point of the funds flow in a business.

It can be understood in two sense, the first one is the actual cash held by firm and deposits can be withdrawn on demand and the second one is, it includes all those items which can be converted into cash immediately like marketable securities. The main goal of cash management in an organisation is to reduce the amount of cash which is there for use within an organisation so as to increase the profitability, but this should be done without reducing the business activities or making prone to the organisation the undue financial risk. The word 'Working Capital' means, the funds considered as necessary for the organisation to carry out day-to-day operations efficiently. Every continuing business unit needs working capital. Working capital is the financial metric that represents the liquidity which is operating in nature and available to a business unit. A company can equip itself with assets and profitability, but it can be of short of liquidity, if these assets cannot easily be converted into cash. Working capital is of two types and they both are interlinked with each other.

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Types of Working Capital

Working Capital is classified based on:

- Concept.
- Time Factor.

Based on Concept

- Gross Working Capital= Current Assets only.
- Net Working Capital= Current Assets less Current Liabilities.

Working Capital Based on Concept

- **Gross Working Capital:** The gross working capital takes into consideration all those capital invested in the total current asset by the enterprise. Current Assets are those assets which can be converted into cash within a short period of time generally one accounting year.

Constituents of Current Assets

It is very essential for a manager to understand the prime responsibility of various constituents. Some of them are:

- Inventories
- Raw Materials.
- Working-In-Progress.
- Stores and spares.
- Finished goods.
- Cash in hand and cash at bank.
- Bills receivables.
- Sundry Debtors.
- Prepaid expenses.
- Accrued incomes.
- Short term loans and advances.
- Marketable securities.
- Temporary investment of surplus funds.
- **Net Working Capital:** Net working capital can either be the two, positive or negative. Current liabilities are those liabilities which are intended to be paid off within a period of one accounting year in the ordinary course of business.

Constituents of Current Liabilities

- Accrued or outstanding expenses.
- Bills payable.
- Bank overdraft.
- Dividend payable.
- Short term borrowings.
- Taxes and dividend payables.
- Sundry creditors.
- Outstanding expenses.

When we see gross working capital concept it depends on going concern or financial concept. On the other hand, the net working capital concept is dependent on accounting concept of working capital. Both of the concepts have their specific merits.

The gross working capital concept is sometimes favoured to the concept of working capital for the following reason-

- It depicts the right amount of working capital of the enterprise at the right point of time.
- Each part of management of the organisation is more interested in total current asset with which the management has to operate then that source from where it will be available.
- It also takes into consideration that with every increase in the amount of fund which will have a favourable effect on the enterprise to increasing working capital.

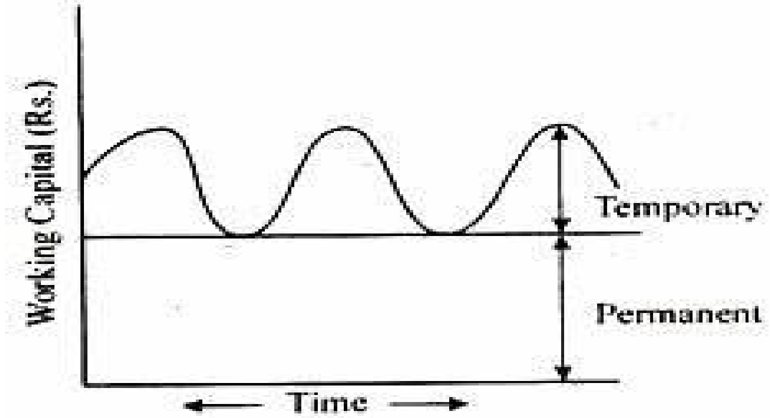
- This concept is very useful when it comes to calculating the rate of return on investment in working capital.

  The net working capital concept is also very important for the following reasons:

- The net working capital is qualitative concept. It indicates the ability of the firm to meet its short-term liabilities and operating expenses.
- It also indicates the margin of the protection which is available to the short-term creditors.
- It acts as an indicator which represents the financial soundness of the enterprises.

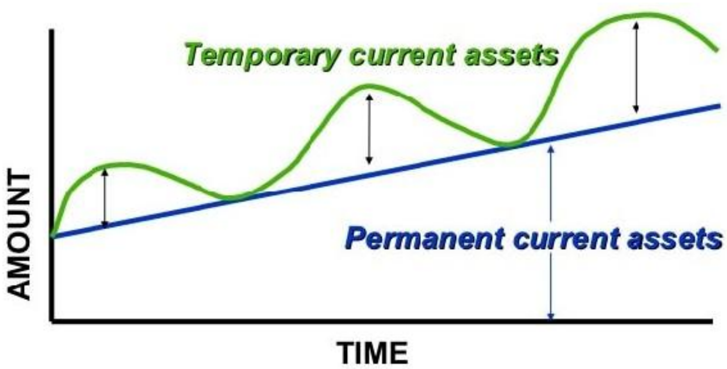
Based on Time Factor

- **Permanent Working Capital:** It is the minimum level of investment which is required at all points of time in the business. It is also known as Fixed or Head Core Working Capital.



- **Temporary Working Capital:** It is that part of working capital which is required over and above the permanent working capital and some of the factors which can affect it are-
  - Peak seasons.
  - Trade cycle boom, etc.

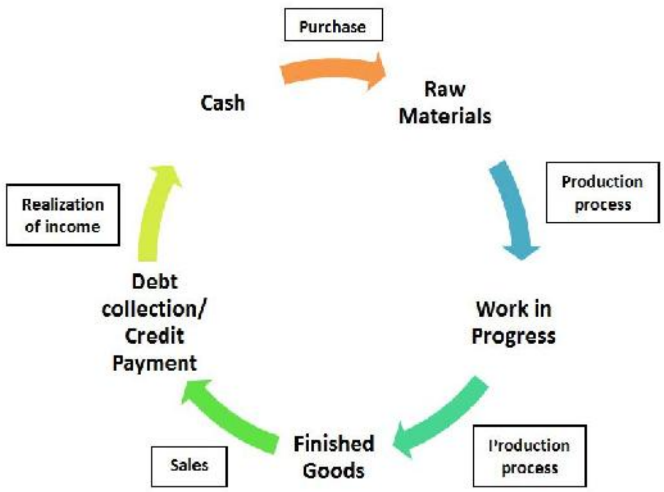
  It is also known as Fluctuating or Variable Working Capital.



Factors Determining Working Capital Needs

- **Nature of business-** The working capital requirement of an organisation is totally dependent on the conduct of the business of the enterprise. The public utility undertaking (like-Electricity, water supply, railways, etc) which need very less working capital but because they offer cash sales and supply only services and not products, so by this no fund is tied up either in inventories or receivables. And at the same time, these organisations invest fewer amounts of cash on fixed assets. And on the other hand, the manufacturing concerns requires huge amount for fixed assets and sizable working capital along with huge fixed investment as these organisations have to pile-up inventories.

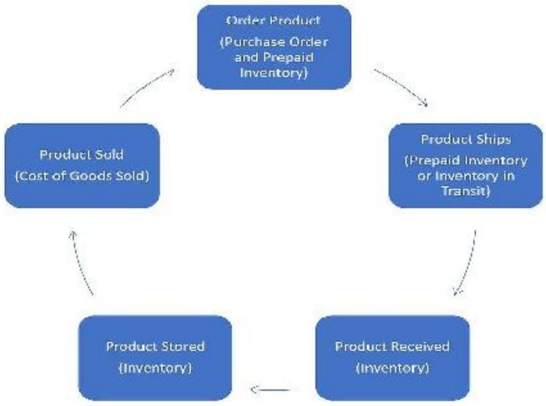
- **Terms of sales and purchase-** It is also the sales of credit in nature granted by the organisation to the consumers or the credit sales granted by the suppliers (suppliers view) also affect the working capital of that particular organisation. And if the credit terms of the supplier is more favourable and on the other side of the coin, the sales which is credit in nature have liberal credit policy then there will be less cash occupied by the inventories. By this we can say that more liberal the credit policy more likely is the case of capital getting stuck in the business and thus reduction in working capital requirement.
- **Manufacturing Cycle-** It is the length of the manufacturing cycle which influence 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

- **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 winter season.

- **Rapidity of Turnover:** If the inventory turnover of an organisation is high, the working capital requirement by that firm will be low. This can be understood by a simple example, let us assume that a business sell its inventories very fast because of the huge demand by the customers in the market (like-FMCG) so this have an impact on the working capital by decreasing the level of its requirement. Because the finished products are converted into cash within a very short period of time. So by this we can also say that if a firm manages and controls its inventories, the firm by that can reduce its working capital requirements. And if we take an example of a firm which is to carry on a slow moving stock, it needs a larger working capital against those who have shorter conversion of inventory to cash period. A firm should have to maintain safety stock (minimum level of stock) throughout the period of the business operation cycle.



Conclusion

Working Capital Management is the relationship between the firm's short-term assets and its short-term liabilities. The basic goal of working capital management is to ensure that 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. This is very important for a manager of an organisation to manage the funds by estimating the future obligations. The managing of working capital involves the following:

- Inventories
- Accounts receivable
- Accounts payable
- Cash

Working Capital is the most important instrument for the organisation when it comes to resolving the financial disorder in the organisation when and where occurs.

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