

WORKING CAPITAL MANAGEMENT: AN OVERVIEW

Ms. Sapna Kumari*
Ms. Inderjeet Kaur**

ABSTRACT

There is a sizable inverse relationship between the return on investment for industrial maintenance companies and the cycle periods of operational working capital. The need of working capital management is emphasized by the fixed assets and high likelihood of maintenance. Due to economies of scale related to fixed assets and working capital as well as the fact that large maintenance service providers frequently concentrate on providing services primarily to their host companies, large maintenance service providers appear to have a competitive advantage over small and medium sized maintenance service providers.

Keywords: Working Capital, Return on Investment, Fixed Assets, Service Providers.

Introduction

The administration of working capital is one of the most crucial aspects of the company's daily operations. The fictitious area of finance known as "working capital management" includes every asset owned by the company. The relationship between a firm's short assets and short liabilities was part of working capital management. Making sure a company can continue to operate with the ability to pay off both maturing short-term debt and impending operating expenses is the aim of working capital management. Generally speaking, from the perspective of the Chief Financial Officer, or CFO, managing working capital is a straightforward idea, and one simple way to guarantee an organization's ability to finance the difference between current assets and current liabilities is to use the "Harris" model from 2005. Since many financial executives are attempting to discover the maintenance of working capital and the fundamentals that the optimal level of working capital, management of working capital is actually one of the most crucial concerns in the organization Lamberson2005. As a result, effective working capital management is a crucial requirement for a firm to operate successfully because it lowers the likelihood of a failure and fosters a sense of security and confidence among employees. It guarantees the organization's ongoing solvency.

Working Capital

There are two basic forms of capital needed for a business: Fixed Capital, Working Capital. Every business needs money for two things: to get started and to run its daily operations. To establish a production facility through the purchase of fixed assets like Plant, Machinery, Land, Buildings, etc. long-term funds are needed. Investment in these assets represents the portion of a company's money that is permanently or consistently blocked, also known as fixed capital. Additionally, money is required for immediate needs such as the acquisition of raw materials, the payment of wages, and daily basis expenses. These resources are referred to as working capital. Working capital is, to put it simply, apportion of a company's capital that is needed to finance short-term or current assets like cash, marketable securities, debtors, and inventories.

Types of Working Capital

Working Capital can be categorized according to concept and according to time. There are typically two types of working capital. These are working capital, both gross and net. But they have several names that describe them. The following explains them.

* Assistant Professor, Department of Commerce, Rayat-Bahra University, Hoshiarpur, Punjab, India.
** Student, Department of Commerce, Rayat-Bahra University, Hoshiarpur, Punjab, India.

In Broad Sense

Working capital, or Gross Working Capital, is what is meant. Additional names for it include financial concept and going concern idea. It refers to the firm's investment in current assets. Assets that can be easily turned into cash or within one accounting year are referred to as current assets. It assists in calculating their turn on investment for working capital and in supplying the appropriate quantity of working capital at the appropriate time.

In Narrow Sense

Net working capital is what is meant by working capital. Another definition for it is an accounting concept. It stands for current assets in excess of current liabilities. It determines a company's ability to pay short-term obligations and shows whether an enterprise financially sounds.

Net Working Capital = Current Assets - Current Liabilities

In conclusion, we can state that both working capitals are significant; however that net working capital is more appropriate for sole proprietorships and partnership firms while gross working capital is more suited for businesses with distinct ownership or management.

Types of Working Capital on the basis of Time

- **Permanent Working Capital:** Furthermore, it is fixed working capital. It indicates that the company must maintain a minimum level of working capital in order to cover its daily costs. For instance, the company must maintain a minimum level of raw materials, finished goods, or cash balance, among other things.
- **Regular Working Capital:** It refers to the bare minimum that the business must retain on hand to conduct day-to-day operations.
- **Reserve Working Capital:** It refers to an excess sum over normal working capital for unforeseen events like strikes or depression.
- **Temporary Working Capital:** It is also known as variable working capital, because it is needed to meet both seasonal and one-time needs.
- **Seasonal Working Capital:** It is necessary to fulfill the Enterprise's seasonal needs.
- **Special Working Capital:** It is necessary for a few unique Enterprise purposes. As an illustration, the company needed special working capital to advertise their product.

Operating Cycle

The portion of a company's capital known as working capital is needed to finance short-term or current assets such as cash, marketable securities, debtors, and inventories. Current assets involve funds that are constantly being converted into cash and having their cash flow reinvested in new current assets. As a result, it is often referred to as circulating and revolving capital. This operating cycle or working capital cycle of a corporation serves as the foundation for the circular flow notion of working capital. The cycle begins with the acquisition of resources and raw materials and concludes with the realization of profits from the selling of finished items. It involves buying raw materials, storing them, and turning them into inventories of finished goods through work in progress with gradually increasing labor and service costs. This cycle then repeats from cash to the acquisition of more raw materials, and soon. The length of an organization's inventories and the conversion time of its receivables make up its gross cycle.

RMCP = Raw materials conversion period.

WIPCP = Work in progress conversion period.

FGCP = Finished goods conversion period.

RCP = Receivables conversion period.

RMCP = (Average Stock of Raw Materials/ Raw Material Consumption per day)

WIPCP = (Average Stock of work in progress/ Total cost of production per day)

FGCP = (Average stock of finished goods/ Total cost of Sales per day)

RCP = (Average Accounts Receivables/ Net credit sales per day)

Business concerns may occasionally acquire raw materials on credit. If so, immediate cash payments are not possible. At the conclusion of the credit period—the time frame that the suppliers have granted—cash will be paid. In this instance, the net operating cycle time is obtained by subtracting the deferred payment term from the gross operating cycle period.

- **Net Operating Cycle Period =** (Gross operating cycle period – Payable Deferral Period)
- **Payable Federal Period =** (Average Payables / Net Credit Purchases per day)

Example: Calculate the cash operating cycle, current ratio, quick ratio, and sales to working capital ratio for Topples Co. and provide a remark.

Given that Topples Co. may have been obliged to provide lax terms of trade in order to lure customers away from its more established competitors, the fact that its receivables days are higher than the industry average may not come as a surprise. Additionally, Topples Cos. could still be creating and putting into practice credit control methods. However, Topples Co. pays its own suppliers more quickly than is normal for the industry. Despite the effect on liquidity, Topples Co. may benefit from settlement discounts offered by suppliers or, as a new firm without a history of profitable operations, it may not be granted extended credit terms by suppliers.

Considering that bad working capital management may be pervasive in the industry and create norms that Topples Companies shouldn't seek to reach, it is important to use the aforementioned sector comparisons with caution. Topples Co. should compare its performance to that of the industry leader as a long-term goal.

Given that Topples Co.'s inventory appears to be moving slowly, the current ratio indicates that there will be \$1.10 in current assets for every \$1 in current liabilities during the projection period, which is less than the industry average of 1.43 and could not be adequate. It follows that the fast ratio, which only shows \$0.42 in liquid assets for every \$1 in current liabilities, is more important, even if there are no statistics on industry averages to compare this number to.

A 36% response rate to the questionnaire survey may be considered high given that it was web-based. As stated in the method, researchers in this field have been defending lower response rates using similar strategies (Adams et al., 2007). 99 companies were contacted; 11 of them immediately responded with a rejection due to, for instance, time constraints. 36 businesses opted to take part and provided their responses. There were 19 small-, 9 mid-, and 8 large-cap enterprises among the 36 total (see Figure 5A). 8 businesses were involved in the IT and telecom sector, 12 in retail, and 16 in manufacturing (See Figure 5B). 8 businesses were involved in the IT and telecom sector, 12 in retail, and 16 in manufacturing (See Figure 5B). There are no noticeable biases in the respondents compared to the non-respondents regarding the size and industry criteria because the sample had a comparable distribution regarding size and industry as the real respondents. Due to their insights into managerial, operational, and financial elements, Chief Financial Officers (CFO) at the organizations were the most frequent respondents. They were also the position first targeted to answer the questionnaire survey. Controllers, accountants, and finance directors, for example, participated in the cases where CFO didn't consequently, positions including management, operations, and finance. An issue with questionnaire respondents was that their likelihood of participating may have been influenced by their interest in and familiarity with the subject. Potential survey respondents who lacked the same interest or could not see the relevance may have gone unnoticed. (The survey is delivered in about 2.)

Nature of Business

Depending on the type or sort of business a firm conducts, a certain quantity of working capital is necessary:

- Less capital is required for public utilities. This is true because they only accept cash as payment and have no trading equity.
- Businesses that engage in trading and providing services need higher working capital since they must maintain substantial inventories. They must also retain a sizable amount of liquid cash, accounts receivable, etc.
- Capital intensive industries require less working capital because they must rely more on machines and less on the workers.

Size of Business

The required amount of working capital depends on the size of the business. For instance, larger businesses need more operating capital than smaller businesses do.

Time and Complexities of Manufacturing Process

The length and complexity of the manufacturing process have an impact on the quantity of working capital needed:

- A longer and more involved manufacturing process necessitates greater working capital. For example, companies manufacturing automobiles need more working capital.
- A shorter, simpler manufacturing process means less working capital is needed. For example, companies involved in manufacturing soaps require less working capital.

Manufacturing Cost

Another element that affects how much working capital is required is the cost of manufacturing. For instance, if a product's production costs are high, then the amount of working capital needed is also higher, and vice versa.

Growth and Expansion

If a business is expanding and growing, it will want more working capital to continue expanding.

Terms of Purchase and Sales

A company's need for working capital depends on the conditions of its sales and purchases:

- If it buys on credit and sells on a cash basis, it needs less working capital.
- On the other hand, if it purchases with cash and sells with credit, it will require greater working capital.

Conditions of Supply

The conditions of supply determine the company's need for working capital:

- If there is a consistent supply of raw materials, the business can maintain inventory control. Consequently, less working capital will be needed.
- However, if the supply is erratic, the business must have extra inventory on hand. As a result, it would require greater working capital in this scenario.

Market Conditions

A company's requirement for operational capital depends on the level of market competition. The company will have to spend a lot of money on advertising and sales promotion if the competition is fierce. It will also need to carry additional inventory and sell on credit. As a result, additional working capital will be required.

Business Cycle

- The need for working capital for a corporation is impacted by the business cycle. A boom and a bust are the two stages of a business cycle.
- Sales are very high during the boom time. The corporation must therefore spend a lot of money at this time on raw materials, salaries, etc. Therefore, more working capital is needed.
- But during the recession, sales drop because individuals prefer to make less purchase. As a result, the company requires less operating capital during this phase.

Operating Cycle

A service company's operating cycle or time-frame is typically brief. Additionally, it does cash sales. Consequently, less working capital is needed. Electricity and transit corporations are two examples. An industrial business often has a lengthy operational cycle. Additionally, it sells on credit. As a result, it calls for extra working capital.

Rate of Turnover

The amount of sales or turnover that a company experiences will determine how much working capital it needs. Less working capital is needed if sales happen quickly and vice versa.

Cash Requirements

A company requires money to cover expenses like salaries, rent, and taxes. If a company's cash demands are high, it requires additional working capital. In other words, when cash flow requirements rise, so will the quantity of working capital required, and vice versa.

Other Factors

Additional elements affecting the need for working capital include:

- Transport facilities
- Changes in price level
- The credit standing of the company

Conclusion

A firm requires working capital to survive. A company's short-term financial health is indicated by a positive WC. Positive WC ratios are a sign of a stable company that is able to pay all of its present commitments. But ultimately, all it is a ratio analysis. Comparatively speaking, supply chain financing is less practical and flexible than working capital management. It enables you to manage your company continually and seize any business chances that present themselves. It is a particularly adaptable and dependable sort of financing for companies that need ongoing working capital. Therefore, supply chain financing is a better choice if you're in a problem and need money straight away. Working capital affects every company's operational efficiency, performance, and growth, but because SMEs often have little working capital, managing this resource is especially important. SMEs are essential to Oman's economic and social development; however, these companies struggle to acquire working capital, which makes it difficult for them to raise working capital. The foundations of working capital management have been discussed in this article, with an emphasis on the analysis of current assets and current liabilities. The four components of working capital—cash, inventory, receivables, and payable—are each specified in detail in the financial management syllabus, and a well-prepared applicant must be proficient in handling them. Net current assets that are readily available for regular business activities are referred to as working capital. Test questions typically touch on inventories, trade payable, trade payable, and bank overdraft.

References

1. Abuzayed, B. (2012). Working Capital Management and Firms' Performance in Emerging Markets: The Case of Jordan. *International Journal of Managerial Finance*, vol. 8(2), 155-179.
2. Berman, B., Evans, J. R., & Chatterjee, P. (2018). *Retail Management A Strategic Approach* (13th ed.). United Kingdom: Pearson Education Limited.
3. Box, G. E., Hunter, J. s., & Hunter, J. S. (1978). *Statistics for Experimenters: An Introduction to Design, Data Analysis and Model Building*. New York: Wiley.
4. Ghozali, I. (2020). *Analisis Multivariat dan Ekonometrika (Teori, Konsep dan Aplikasi dengan E-views 10)* (2nd ed.). Semarang: Badan Penerbit Universitas Diponegoro.
5. Gitman, L. J., & Zutter, C. J. (2015). *Principles of Managerial Finance* (14th ed.). United States of America: Pearson Education.
6. Korajczyk, R., & Levy, A. (2003). Capital Structure Choice: Macroeconomic Conditions and Financial Constraints. *Journal of Financial Economics*.
7. Keown, A. J., & et al. (1999). *Dasar-Dasar Manajemen Keuangan*. (C. D. Djakman, Trans.) Jakarta: Salemba Empat
8. Mbawuni, J, Mbawuni, M. H., & Nimako, S. G. (2016). The Impact of Working Capital Management on Profitability of Petroleum Retail Firms: Evidence from Ghana. *International Journal of Economics and Finance*, vol. 8, 49-62.
9. M. J. McClendon (2002). *Causal Analysis and Multi-Regression*. Illinois: Long Grove: Waveland Press.
10. Mapharing, M., Selinkie, P., R., S. C. (2018). Working Capital Management's Effect on Profitability: Bostwana's Listed Retail Stores as Evidence. Volume 4, Pages 82–94 of *Applied Finance and Accounting*.

