The management of working capital is the most significant aspect of overall financial management. It is the decision making process regarding the amount and composition of current assets as well as their sources of finance. The basic objective of all these decisions is to manage the current assets and current liabilities in such a manner that a satisfactory level of working capital is maintained. Working capital management usually is considered to involve the administration of current assets—namely, cash and marketable securities, receivables, and inventories—and the administration of current liabilities. Each of the current assets must be managed efficiently so as to maintain the liquidity of the firm while keeping them at optimum levels. Similarly, short-term sources of finance must be managed in such a way so as to ensure that they are obtained and used in the best possible way. In other words, a proper balance between risk, liquidity and profitability must be maintained. K.V. Smith has rightly observed 'Working capital management is concerned with the problem that arise in attempting to manage the current assets, current liabilities and inter-relationship that exist between them.'
Thus the main issues concerning the management of working capital are:

(a) Estimating the working capital requirement
(b) Deciding the optimum levels of investment in various current assets
(c) Finding out the optimum mix of short-term funds and long-term funds to finance current assets
(d) Selecting the appropriate sources to finance the current assets.

IMPORTANCE OF WORKING CAPITAL MANAGEMENT

Working capital management is an integral part of overall corporate management. The success of the operations of an enterprise depends heavily on the manner in which the working capital is managed. It is the basic and broad measure of judging the performance of a business firm. 'Working capital may be regarded as the lifeblood of a business; its effective provision can do much to ensure the success of a business while its inefficient management can lead not only to the loss of profits but also to the ultimate downfall of what otherwise might be considered as a promising concern.'

The importance of working capital management originates from the fact that current assets form a substantial portion of the total investment in most business enterprises.
Secondly, variations in sales make it imperative for the management to make rapid adjustments in current assets and current liabilities. Although fixed assets investment and long-term borrowings also change due to variation in sales, such variation is weak. Therefore the finance manager has to spend a good deal of time in managing current assets and current liabilities. Some finance experts consider working capital management as 'the driving seat of a finance manager.'

CONCEPT OF WORKING CAPITAL

Working capital is the amount of capital required by a business unit to carry on its day-to-day operations and in particular to complete an operating cycle. There are two concepts of working capital that are in vogue in financial management circles. One is Gross Working Capital and the other is Net Working Capital. Gross Working Capital refers to the sum total of all the current assets of an enterprise. Whereas Net Working Capital represents the difference between the current assets and the current liabilities of an enterprise.

'The term current assets is used to designate cash and other assets or resources commonly identified as those which are reasonably expected to be realised in cash or sold or consumed during the normal operating cycle of the
In other words, current assets are those assets which are usually turned into cash within a year or within the normal operating cycle of a business, whichever is greater. These include inventories, receivables, cash and bank balances, investments (of a readily realisable nature and made on temporary basis), advance payment for taxes, pre-paid expenses, advances for purchase of raw materials, stores and spares. Current liabilities are obligations which become due for payment in a short period, usually within a year, and include short-term bank borrowings, sundry creditors (trade), bills payable, advance payments from customers, outstanding expenses and other statutory liabilities.

The gross working capital concept is quantitative in character. It emphasises the level of current assets for a given level of activity. It is useful in measuring the size and extent to which current assets are being used in the day-to-day operations of a business enterprise. In order to increase productivity from other assets and to realise greater return on investments, the finance manager is concerned primarily with gross working capital. It shows a firm's credit worthiness based on the going concern concept.

Net working capital, which is the difference between the current assets and current liabilities, is useful in evaluating the liquidity position of an enterprise. The
concept is qualitative in character, explaining how the current assets in excess of current liabilities have been financed. These may be financed by proprietors in the form of share capital or from internal sources such as retained earnings or from external sources in the form of long-term borrowings. L.J. Gitman has defined net working capital as 'that portion of a firm's current assets financed with long-term funds.'

'.....the gross and net working capital concepts present two distinct and important facets of working capital management. There is no standard prescription setting out the precise amount of gross or net working capital, that each enterprise needs. Nor is there any commitment to specific mix or piecemeal financing tied to particular classes of assets. There is no stipulation that short-term uses should be wholly financed by short-term sources. Nor will this be feasible in practice.'

CLASSIFICATION OF WORKING CAPITAL

1 Permanent or Regular Working Capital

It is that amount of current assets viz., cash, inventories and receivables which is required to be maintained in the business continuously even if sales are reduced to the minimum. However, this amount varies with the growth in sales volume. It exists on a continuing basis over
the entire year and has its significance from the financing point of view because long-term funds are generally raised to finance these assets.

2 Temporary or Variable or Seasonal Working Capital

It represents that amount which is over and above the permanent working capital. It varies with the variations in the operations of the business. Generally, short-term sources of funds are used to finance this part of current assets.

CIRCULATING CAPITAL

Working capital is also known as circulating capital because all the current assets keep on changing from one form to another in the ordinary course of business. In the beginning funds are obtained from the shareholders and supplemented by long-term borrowings. Further, funds are also raised in the form of cash credit/bank overdraft or credit facilities with the suppliers of goods and services. A portion of funds is used to acquire fixed assets and the remaining part is used to purchase raw materials and for day-to-day operations. From this point starts the circulation of funds. Raw material moves into the production process. After passing through the work-in-progress stage it is converted into finished goods which are sold for cash or on credit. With the collection of book debts cash is again
This cyclic process continues throughout the life of the business and the values of the enterprise keep on moving through cash-to-cash path.

Therefore, working capital is also called circulating capital.

THE CONCEPT OF OPERATING CYCLE

The operating cycle concept is the basic concept to understand the working capital requirements of an enterprise. The working capital requirements are very much dependent on the operating cycle of the business. In a normal product manufacturing enterprise the duration of the operating cycle is the time period required to complete the following sequence of events:

1. Storage of raw materials and stores
2. Work-in-process period i.e. the period of converting raw materials into finished goods
3. Storage of finished goods before sales
4. Receivables collection period.

From the total of the above four periods credit period allowed by the suppliers is to be deducted. The number of days so obtained is the duration of the operating cycle of the manufacturing enterprise.
Thus, in simple words, the operating cycle is measured in terms of the number of days required at each stage beginning with the acquisition of raw material, its storage, conversion into finished product and realization of money from debtors, with reasonable adjustment for credit period allowed by the suppliers.

K.V. Smith rightly observes 'the continuing flow from cash to suppliers, inventory to accounts receivable and back into cash is what is called the operating cycle.'

**COMPOSITION OF WORKING CAPITAL**

For proper evaluation of working capital management performances, a closer scrutiny of individual composite items of working capital is essential. The frequently noted constituent parts are as under:

**CURRENT ASSETS**

**Inventories**

Raw materials and production stores including those in transit, stores and spares, work-in-progress, finished goods.

**Receivables**

Trade debts arising out of sales.
Cash and Bank Balances

Cash on hand,
Cash at bank,
Cash in transit

Investments

Investments of readily realisable nature

Other Current Assets

Advance payment of tax (Net of tax provisions)
Pre-paid expenses

Advances to suppliers of raw materials, components and consumable stores.

CURRENT LIABILITIES

Short - term bank borrowings
Non bank short - term borrowings
Sundry creditors
Advance payments from customers
Interest accrued on loans
Outstanding expenses
Statutory liabilities
Any other outstanding liabilities currently payable
Current provisions - tax provisions (net of advance income tax), dividend payable, etc.
FACTORS AFFECTING WORKING CAPITAL NEEDS

There are no set rules or formulae for determining the working capital needs of an enterprise which are influenced by a good number of factors. The relative significance of these factors varies from time to time even in the same firm. Some of the important factors which generally influence the working capital requirements of an enterprise are described below:

Nature of Business

The nature of business is the basic factor influencing the working capital requirements of a firm. More working capital is needed in trading and industrial concerns as compared to public utility services which need less working capital. For example, an electric supply undertaking or a transport undertaking can operate with less current assets due to the cash nature of its business and secondly, it sells services instead of a product consequently it is not required to maintain big inventories. On the other hand a manufacturing concern with a long operating cycle and selling largely on credit basis would require a large amount of working capital.

Conditions of Supply

The level of inventory depends upon the conditions of supply. An enterprise can manage with less funds if the
supply of the raw materials is prompt and adequate. On the contrary, if the supply is seasonal and unpredictable, large investments will have to be made in inventories to carry on production operations round the year and hence more funds will be required.

Credit Policy of the Enterprise

Credit terms allowed to customers by the firm have a great influence on the working capital requirements. A firm allowing liberal credit terms will require more working capital. On the other hand a firm selling goods on cash basis will require a lower amount of working capital.

Availability of Credit

An enterprise enjoying the credit facility from suppliers and banks on favourable conditions can operate with less working capital than an enterprise which do not enjoy such facility. So the availability of credit also influence the working capital requirements.

Production Policy

The requirements of working capital will vary sharply in accordance with seasonal fluctuations in sales. In case of seasonal business, firms can either follow steady production policy or a policy of fluctuating production during peak and slack seasons. In case of steady production
more working capital is required to finance accumulating inventories.

Growth and Expansion Activities

A growing concern needs more working capital than an established concern. As the firm grows in terms of sales or fixed assets, the working capital requirements also increase. Advance planning of working capital is a continuing necessity of a growing concern.

Price Level Changes

Changes in price level have a great influence on the working capital requirements of an enterprise. With the increase in price level an enterprise will have to maintain a higher amount of working capital for the same level of current assets. However, if the increase in price level can be offset by increased prices of company's products, working capital problem will not hit the enterprise severely.

Business Cycle

The business cycle also has an influence on the requirements of working capital. During the boom period, manufacturers will like to produce more for sale in a buoyant market and during the period of depression, the producers are forced to carry large inventories due to slack market conditions. Thus, both boom and depression periods result in increased requirement of working capital.
Manufacturing Process

The length of period of the manufacturing process will determine the time for which investment will remain blocked in various components of the inventory. If the time required in the manufacturing process is longer, the working capital requirements will be higher and vice-versa.

Liquidity and Profitability

Investment in working capital also depends upon the policy of the management regarding liquidity and profitability. If the management's policy is to improve liquidity, it will increase the size of working capital in relation to sales, resulting in reduced risk and profitability.

Other Factors

Apart from the factors mentioned above there are a number of other considerations which affect the amount of working capital. If the management is unable to keep proper coordination between production and distribution it will result in a higher amount of working capital. Secondly, lack of adequate means of transport may compel an enterprise to maintain big inventories of raw materials and other accessories resulting in greater demand for working capital. Thirdly, economic and political environments also affect the working capital requirements of an enterprise.
PRINCIPLES OF WORKING CAPITAL MANAGEMENT

E.W. Walker has laid down four principles of working capital management. The Finance Manager should consider these principles as basic guidelines for framing the policies governing the amount and type of working capital in a business firm. These principles are as follows:

Principles of Risk Variation

This principle states that if the working capital is varied relative to sales, the amount of risk that a firm assumes is also varied and the opportunity for gain or loss is increased. Risk here refers to the inability of an enterprise to maintain sufficient current assets to (i) meet all financial obligations as they mature, and (ii) support the proper levels of sales. So it follows from this principle that there is a definite relationship between the degree of risk and the rate of return. When the level of working capital in relation to sales decreases, the degree of risk increases; consequently the opportunity for gain or loss also increases. Contrary to this, when the level of working capital increases the degree of risk decreases, thus affecting the opportunity for gain or loss adversely. Therefore, the risk involved in various levels of current assets and current liabilities must be evaluated in relation to the profitability associated with these levels.
Principle of Equity Position

According to the second principle, capital should be invested in each component of working capital as long as the equity position (net worth) of the firm improves. Every rupee invested in working capital should contribute towards the net worth of the enterprise.

Principle of Cost of Capital

This principle lays emphasis on the risk resulting from the type of capital used to finance current assets. It states that the type of capital used to finance the working capital directly affects the amount of risk that a firm assumes as well as the opportunity for gain or loss and cost of capital. There are different sources of finance possessing varying degrees of risk. The cost of capital of each source differs from the other, depending upon the degree of risk. So the optimum size of working capital should be determined after considering both the risk and cost of capital.

Principle of Maturity of Payment

This principle states that the greater the disparity between the maturities of a firm’s short-term debt instruments and its flow of internally generated funds, the greater the risk and vice versa. Therefore, the Finance
Manager should try to relate the maturities of payment to its flow of internally generated funds so that there should be least disparity between the maturities of an enterprise's short-term debt and the flow of internally generated funds.

FINANCING WORKING CAPITAL

The main problem in working capital management is deciding upon the financing policy. Both long-term sources and short-term sources are used to finance the current assets of an enterprise. The long-term sources of finance provide support for a small part of current assets which is termed as net working capital. It is the excess of current assets over current liabilities. The total current assets of an enterprise can be divided into permanent current assets and temporary or variable current assets. Permanent current assets represent the minimum level of current assets required to maintain a firm's daily operations. Temporary or variable current assets are those assets which fluctuate with the operational needs of the firm.

There are several financing plans that the management can adopt to finance the current assets. The most common types are:

(i) Matching or Hedging Policy
(ii) Conservative Policy
Matching or Hedging Policy

This policy involves the matching of the expected life of assets with the expected life of funds raised. Under this policy of financing, each asset would be offset with a financing instrument of approximately corresponding maturity. The basic assumption underlying the policy is that the implied cash flow pattern is known with certainty. According to this approach, temporary current assets should be financed by spontaneous sources of financing such as creditors, payables and outstanding expenses, as well as short-term borrowings. Permanent current assets and fixed assets should be financed by long-term debt and equity.

The underlying logic is that if the firm finances a part of its permanent current assets with short-term finances, it increases the risk of funds shortage at the time of maturity of such short-term debts. On the other hand, if long-term finances are used to finance a part of temporary current assets, there will be times when excess funds may remain idle or have to be invested in low yielding securities, thus increasing financing cost. Hence the matching policy ensures lesser risk and lower financing costs.
Conservative Policy

The matching policy is based on the assumption that the cash flow pattern is known with certainty and that the management can easily determine at any time which portion of current assets is a temporary investment and which portion is permanent. In practice, it may not always be possible to follow the exact matching approach because of the reasons: (i) permanent current - asset requirements may vary on account of temporary expansion or contraction of these assets (ii) uncertain borrowing costs and non availability of adequate credit when needed. Therefore, a firm may choose to follow a conservative policy which ignores the distinction between temporary and permanent current assets. Under this policy almost all the asset investments are financed with long - term capital. Temporary swellings in current assets that cannot be supported by spontaneous financing sources are financed by long - term funds. During the off season, the level of current assets contracts and liquidity is stored in the form of short - term marketable securities. The conservative strategy is safest in terms of risk of illiquidity (as the firm depends heavily on long - term funds) but is less profitable because of higher financing cost.
Aggressive Policy

An aggressive approach involves the use of more short-term sources of financing than warranted by matching policy. Under this approach short-term funds are used to finance not only temporary but also part or all of the permanent current-asset requirements. Sometimes short-term credit is used to finance a part of fixed assets also. It is the actual position in some of the business enterprises in India. This approach increases the risk of illiquidity because short-term finance involves uncertainty as to interest rates and the availability of finance itself.

Balanced Policy

The conservative policy and the aggressive policy are of an extreme nature while the matching policy involves practical difficulties in its implementation. In order to overcome the shortcomings of these policies most managements prefer to go for a compromise policy. This is termed as the balanced policy. Under this approach permanent current assets and a part of temporary current assets are financed by long-term funds. For the remaining working capital requirements during the peak season short-term funds are employed. After paying off the funds borrowed during the peak season surplus funds are stored in the form of marketable securities.
This policy is relatively safer as compared to other policies. Any unexpected increase in temporary current assets can be financed by using unused short-term credit sources. On the other hand less than expected contraction in current assets will not affect the short-term payments. It will only affect the surplus cash to be invested in marketable securities.

**SOURCES OF WORKING CAPITAL FINANCE**

A number of sources can be explored by an enterprise to meet its financial requirements. Current assets are normally financed by a combination of long-term and short-term sources. The long-term sources of finance include equity share capital, preference share capital, long-term borrowings and retained earnings, etc. They provide support for a relatively small proportion of working capital requirements, while short-term sources, representing current liabilities, provide for a major proportion of current asset financing. In selecting a particular source the enterprise has to consider the merits and the demerits of each available source.

The significant sources of working capital finance may be classified as follows:

(i) Bank credit
(ii) Trade credit and accruals
Current provisions and non-bank short-term borrowings

Long-term sources comprising owner's equity and long-term borrowings.

Of the above mentioned sources, short-term bank credit is the primary institutional source for financing working capital requirements. This facility is made available to industry under different arrangements with the banker, the prevalent forms of which are elaborated below:

(a) **Short-term bank loan**

Under this scheme the entire amount of loan is credited by the bank to the borrower's account and the interest is payable on the total outstanding balance.

(b) **Overdraft**

As per this type of arrangement the borrower is allowed to overdraw from his current account up to a stipulated limit and the interest is payable on the amount actually utilised.

(c) **Cash Credit Arrangement**

This arrangement allows the borrower to withdraw up to a stipulated limit based on security margin. Commitment charges of 1 per cent are paid by the borrower on the under utilised balance during a particular period. Cash credit is a loan account whereas overdraft means that the account may
be overdrawn for a short period as and when the requirement arises. But in practice both are utilised in the same manner and the two terms are more or less interchangeable.

(d) Bill Discounting

Under this system bank credit is made available through the discounting of bills by the banks. Trade bills of the customer are discounted by the bank and on maturity the bills are presented for collection. After the collection of bills the bank squares off the borrower's account. Lending through the scheme of bill discounting is usually preferred by banks as the banker holds a bill as security.

FINANCING OF WORKING CAPITAL - RECOMMENDATIONS OF VARIOUS COMMITTEES

Since the nationalisation of major commercial banks, bank credit to industry has been the subject matter of regulations and control. The idea behind nationalisation was to ensure equitable distribution of bank credit to various sectors of the economy and to secure its adjustment to planning priorities. In this regard, three reports are of special significance:

(a) Dahejia Committee Report, 1969.
(b) Tandon Committee Report, 1975.
(c) Chore Committee Report, 1979.
DAHEJIA COMMITTEE

The National Credit Council constituted a study group in October 1968 under the chairmanship of Shri V.T. Dahejia to examine the extent to which the credit needs of industry and trade are likely to be inflated and how such trends can be checked. In this context the term 'inflation' means that borrowers have received credit in excess of their genuine requirements.

The major observations of the group in its report, submitted in September 1969, were:

(i) There was a general tendency on the part of industry to avail itself of short-term credit from banks in excess of the amount based on the growth in production and/or inventories, in value terms.

(ii) Cash credit advances by banks were only technically repayable on demand and these were not necessarily utilised for short-term purposes.

The study group recommended the segregation of outstanding as well as future credit amounts into (a) the hard core of working capital which represents the minimum level of raw materials, finished goods and stocks which the industry is required to hold for maintaining a given level of production. (b) Strictly
short-term component representing the requirement of funds for temporary purposes. The group further recommended the segregation of the hard core element in the cash credit borrowings and to put it on a formal term-loan basis, particularly in cases where the company's repaying capacity was good. The question of determination of hard core and fixation of industry-wise norms for inventory levels was left to The Reserve Bank of India.

The recommendations of Dahejia Committee remained unimplemented.

**TANDON COMMITTEE**

In July 1974, the Reserve Bank of India appointed a study group to frame guidelines to follow-up and supervise bank credit under the chairmanship of Shri P.L. Tandon, the then chairman of Punjab National Bank. The following were the terms of reference to the committee:

1. To suggest guidelines for commercial banks to follow-up and supervise credit from the point of view of ensuring proper end-use of funds and keeping a watch on the safety of advances and to suggest the type of operational data and other information that may be obtained by banks periodically from such borrowers and by the Reserve Bank of India from the lending banks.
(2) To make recommendations for obtaining periodical forecasts from borrowers of
   (a) business/production plans
   (b) Credit needs.

(3) To make suggestions for prescribing inventory norms for different industries both in private and public sectors and to indicate the broad criteria for deviating from these norms.

(4) To suggest criteria regarding satisfactory capital structure and sound financial basis in relation to borrowings.

(5) To make recommendations regarding the sources for financing the minimum working capital requirements.

(6) To make recommendations as to whether the existing pattern of financing working capital requirements by cash credit/overdraft system, etc. requires to be modified; if so, to suggest suitable modifications.

(7) To make recommendations on any other related matter that the group may consider germane to the subject of enquiry or any other allied matter which may be specifically referred to it by the Reserve Bank of India.

Three sub-groups were set up by the committee for three fields, covering:
(i) The norms for current assets
(ii) Credit policy issues
(iii) Follow-up information system.

**RECOMMENDATIONS OF THE GROUP**

The study group submitted its report to the Reserve Bank of India in August 1975. An abstract of the group's main observations and recommendations is given below:

1. **Norms for Inventory and Receivables**

   One of the significant recommendations of the Tandon Committee was establishing the inventory and receivables norms for 15 major industries. These industries constituted 50 per cent of the industrial advances of banks at that time.

   The norms recommended by the study group relate to (i) raw materials including stores and other items used in the process of manufacture expressed as so many months' 'consumption' (ii) stock-in-process expressed as so many months' 'cost of production' (iii) 'finished goods and receivables expressed as so many months' 'cost of sales' and 'sales' respectively. These figures represent only the average levels and in individual cases, keeping in view the special circumstances in which a unit works, the bank may deviate from these norms.
Working capital requirements pertaining to heavy engineering industry were not covered under the norms keeping in view the special characteristics of the industry, particularly the large tie-up of funds in current assets. The groups suggested that these norms should be progressively extended to cover more and more industries. Since the implementations of Tandon Committee report, a number of changes have been made in the norms and the list of industries but the basic structure of the norms has remained the same.

Lending Norms

In addition to suggesting the norms for inventory and receivables another important recommendation of the Tandon Committee pertains to the lending norms being followed by banks while extending short-term credit to borrowers. The committee suggested three methods for determining the maximum permissible limit of bank borrowings. These methods are as follows:

Method I

Under this method, a bank can finance upto a maximum of 75 per cent of the working capital gap and the balance will be financed by the borrower from long-term funds i.e. his own funds and long-term borrowings. Working capital gap is defined as the total of current assets less current liabilities other than bank borrowings.
Method II

In this method, the borrower is required to provide from his own resources, long-term funds, a minimum of 25 per cent of total current assets. The banker will provide the funds to meet the working capital gap.

Method III

The third method suggests that the borrower's contribution from long-term funds is to the extent of the entire core current assets plus a minimum of 25 per cent of 'real current' assets. Total current assets less core current assets will represent 'real current assets'. In case non-bank current liabilities are not sufficient to cover the balance 75 per cent of real current assets, the required amount will be obtained by way of bank borrowings to maintain the requisite level of current assets. The committee did not prescribe the criteria for determining core current assets but suggested that this may be taken up by the Working Group to be formed by the Indian Banks' Association.

The three methods discussed above can also be regarded as sequential stages in the approach to bank lending. Each successive method increases the involvement of long-term funds and reduces the involvement of short-term bank credit to finance current assets.
The committee further recommended that the classification of current assets and current liabilities for computing the permissible level of bank finance should be made as per the usually accepted approach of banks, and not as per definition in the Companies Act.

The committee suggested that in the beginning all borrowers who had credit limit in excess of Rs. 10 Lakhs with the banking system should be placed in the first method within a period of one year and then shifted to the second and the third method in stages. In fact the committee desired that the borrowers should gradually reduce their dependence on bank credit for financing their working capital needs.

3. Style of Credit

In view of the wide gap between the sanctioned credit limits and the limits actually utilised by the borrowers, the committee suggested that instead of keeping the entire permissible limit open for availment in the cash credit account, the limit should be bifurcated into two parts viz., a loan comprising the minimum level of borrowings which the borrower expects to utilise throughout the year; and a demand cash credit to meet fluctuating requirements. Both the parts should be reviewed annually.
The Committee further suggested differential interest rates for loan and cash credit components with relaxation for sick units.

4. Information System

The Committee advocated a greater flow of information from the borrower to the lender bank. The idea behind information flow is that the bank should be treated as a partner in the business. Submission of information would facilitate in-depth study of performance and credit utilisation. It will form the basis for reviewing the existing limit and provide a measure for timely action in case of excessive or under utilisation of credit limits.

CHORE COMMITTEE

In April 1979, the Reserve Bank of India set up a study group under the chairmanship of Sh. K.B.Chore, Chief Officer, Department of Banking Operations and Development, Reserve Bank of India to review the operation of cash credit system. The followings were the terms of reference:

1. To review the operation of cash credit system in recent years, particularly with reference to the gap between sanctioned credit limit and the extent of its utilisation.
(ii) In the light of the review:

(a) to suggest modifications in the cash credit system with a view to making the system more amenable to rational management of funds by commercial banks, and/or

(b) alternative types of credit facilities, which would ensure greater credit discipline and also enable banks to relate credit limits to increase in output or other productive activities.

The group submitted its report in August 1979, wherein it made several recommendations.

The committee specifically recommended that banks should follow the second method of lending as suggested by the Tandon Committee for determining the maximum permissible limit for bank finance. According to this method the borrower should contribute at least 25 per cent of current assets from his own funds and term loans. As many of the borrowers may not be in a position to comply with this requirement immediately, the excess borrowings should be segregated and treated as working capital term loan which should be made repayable in instalments within a definite period which should not exceed five years in any case. With a view to inducing the borrowers to repay this loan, a comparatively higher rate of interest should be charged.
Another significant recommendation of the group was that banks should ensure that at least once a year a review is made of a borrower’s account having a working capital limit of Rs. 10 lakhs and above. On the basis of utilisation of credit limit by a borrower in the past, the bank should fix separate limits for the normal non peak level and also for peak level credit requirements; and the borrower should indicate in advance his quarterly requirements of funds, within the sanctioned limits, before the commencement of each quarter.

In addition to the above, the committee also recommended that the borrowers should be discouraged from frequently seeking ad hoc or temporary limits in excess of sanctioned limits to meet unforeseen contingencies. Additional interest of one per cent per annum should be charged for such limits.

The main aim of all the above recommendations was to reduce the dependence of large and medium borrowers on bank finance for working capital needs.
NOTES AND REFERENCES


11. Ibid, pp. 66-78.