CHAPTER 5

WORKING CAPITAL MANAGEMENT

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5.1 INTRODUCTION

5.1.1 Working capital management is usually considered to involve the administration of current assets — namely, cash and marketable securities, receivables and inventories and the administration of current liabilities. By accounting definition, current assets are those, which can be converted into cash within one accounting year. Administration of fixed assets, on the other hand, is usually considered to fall within the scope of capital budgeting. Management of working capital is therefore concerned with the problems that arise in attempting to manage the current assets, the current liabilities and the interrelationship that exists between them. In other words, it refers to all aspects of administration of both current assets and current liabilities.

5.1.2 "The management of fixed and current assets, however, differs in three different ways".1

1. In managing fixed assets, time is a very important factor; consequently, discounting and compounding techniques plays a significant role in capital budgeting and a minor one in management of current assets.

2. The large holding of current assets, especially cash, strengthens firms' liquidity position, but it reduces the overall profitability.
3. Levels of fixed assets as well as current assets depend upon expected sales, but it is only current assets, which can be adjusted with sales fluctuation in the short run.

5.2 DIMENSIONS OF WORKING CAPITAL MANAGEMENT

5.2.1 The firm should maintain a sound working capital position and there should be optimum investment in working capital. The financial manager must determine levels and composition of current assets. He must see that right sources are tapped to finance current assets, and that current liabilities are paid in time. "There are many aspects of working capital management, which make it an important function of financial manager":

- Working capital management requires much of the financial manager's time.
- Working capital represents a large position of the total investment in assets.
- Working capital management has greater significance for small firms.
- The need for working capital is directly related to sales growth.

5.2.2 Working capital management policies of a firm have a great effect on profitability, liquidity, and structural health of the
organisation. Let us pinpoint its significant dimensions, which require the attention of financial executives.

1. Managing investment in current assets:

   Determination of appropriate level of investment in current assets is the first and foremost responsibility of working capital manager. Although the amount of investment in current assets varies from day-to-day, the average amount or level over a period can be used in determining the fluctuating and permanent investment in current assets.

2. Financing of working capital:

   Another important dimension of working capital management is determining the financial mix for working capital, which may be a combination of spontaneous, short-term and long-term resources. Spontaneous sources of financing consist of trade credit and other accounts payable that arise spontaneously in the firms' day-to-day operations. In addition to trade credit, wages and salaries payable, accrued interest and accrued taxes also provide the firm with valuable sources of spontaneous financing. Bills payable, short-term bank loans, inter-corporate loans, commercial papers are the most common examples of short-term sources of working capital finance.
3. Inter-relatedness:

Inter-relatedness is the most distinguishing characteristics of working capital decisions. The desired level of inventory for a period is depending upon sales. Further, no decision regarding inventory and sales could be made without considering the implications for account receivables. We now consider some of the links between current assets and current liabilities. If sales increase, purchases must increase to maintain a constant level of inventory and growing sales will usually require greater inventory investment and purchases. Unless the firm purchases on cash terms, an increase in purchases will lead to an increase in accounts payables. Thus an increase in inventory will be financed spontaneously with trade credit. The amount of trade credit financing will depend upon decisions regarding payments. Inventory decisions are thus linked to credit decisions.

The working capital managers thus have to pay attention to the inter-related nature of current assets and current liabilities and take into account major interactions that influence the working capital investment and financing decisions.

4. Volatility and reversibility

Another significant feature of working capital management is that the amount of money invested in current assets can change rapidly, and so does the financing require. The level of investment in current assets is influenced by a variety of factors, which may
be as erratic as labour unrest. The seasonal and cyclical fluctuations in demand are the common cause of rapid changes in investment in current assets and the financing required.

5.3 TOOLS AND TECHNIQUES FOR MANAGING INVENTORY

5.3.1 Every enterprise needs inventory for smooth running of business. It serves as a link between production and distribution processes. The unforeseen fluctuation in demand and supply of goods also necessitate the need for inventory. "In India, a study of 29 major industries has revealed that the average cost of materials is 64 paisa and cost of labour and overhead is 36 paisa in a rupee. Inventories are about 60 percent or more of current assets in tea plantation, edible vegetables and hydrogenated oils, sugar, tobacco, cotton, jute and woolen textiles, non-ferrous metals (other than aluminium industry), transport equipment and foundries and engineering workshops. It is about 30 percent and below in printing and publishing, electricity generation and supply, trading and shipping industries. It is as high as 76 percent in tobacco industry".

5.3.2. It is therefore, necessary to manage inventories efficiently in order to avoid unnecessary investment in them. An undertaking neglecting the management of inventories will be affected in the long-run profitability. The following are important tools and techniques of inventory management and control.
1. Determination of stock levels.
2. Determination of safety stock.
3. Economic order quantity.
4. ABC analysis.
5. VED analysis.
6. Inventory turnover ratio.
7. Aging Schedule of inventories.
8. Perpetual inventory system.
10. Inventory reports.

These techniques are discussed briefly as follows:

1. Determination of stock levels:

In order to guard against the dangers of under-stocking and over-stocking, most of the large organisation adopts a scientific approach of fixing stock levels. The various levels fixed for effective control of materials are maximum level, minimum level, reordering level, danger level and average stock level. These levels serve as basis for initiating action in time, so that the quantity of material is controlled.

Maximum level:

Maximum level indicates the maximum quantity of an item of material, which can be held in stock at anytime. The fixation of maximum level is necessary to avoid unnecessary blocking up of
capital in inventories and to save the storage space. While fixing this level, the following factors are to be taken into account.

i) Rate of consumption of materials

ii) Availability of storage space

iii) Maximum requirements of the store at any particular point of time

iv) Availability of working capital

v) Risk of obsolescence and deterioration

vi) Cost of storage and insurance

vii) Reorder quantity

viii) Possibility of fluctuation in prices

ix) Restrictions imposed by the government

x) Possibility of change in fashion etc..

The maximum stock level is computed by the following formula.

\[
\text{Maximum level} = \text{Re-ordering level} + \text{Reorder Quantity} - (\text{Minimum consumption} \times \text{Minimum Reorder Period})
\]

**Minimum Level:**

The minimum level indicates the lowest quantitative balance of an item of material, which must be maintained. It is that level below which stock should not normally be allowed to fall. This stock is maintained primarily to avoid stoppage of production due to deficiency of stock. This stock level should be decided by taking into account the following matters:
i) Rate of consumption of materials

ii) Maximum time required for fresh suppliers

iii) Re-order level

iv) Nature of materials

The minimum stock level is computed by the following formula.

\[ \text{Minimum level} = \text{Reordering level} - (\text{Normal consumption} \times \text{Normal Reorder period}) \]

**Reorder level:**

This is that level of material at which purchase requisition is initiated for getting fresh supplies. The reordering level is fixed between the maximum level and minimum level in such a way that by placing a fresh order at this point. Reorder level mainly depends on the following factors:

i) Maximum consumption

ii) Lead time i.e., the expected time lag between the date of placing the order and the date of actual receipt of material

iii) Rate of consumption.

The Reorder level is fixed with the following formula.

\[ \text{Reorder level} = \text{Maximum consumption} \times \text{Maximum Reorder period} \]
Danger Level:

It is the level of stock below which, the material stock should never be allowed to fall in normal circumstances. This level is fixed generally below the minimum level.

Danger level is determined by the following formula.

\[ \text{Danger level} = \text{Average consumption} \times \text{Maximum Reorder period}. \]

Average Stock level:

The average stock level is calculated by the following formula.

\[ \text{Average Stock level} = \text{Minimum stock level} + \frac{1}{2} \text{ of Reorder quantity}. \]

2. Determination of safety stock:

Safety stock is a buffer to meet some unanticipated increase in usage. The usage of inventory cannot be perfectly forecasted. The demand for materials may fluctuate and delivery of inventory may be delayed. In such a case, the firm can face a problem of stock-out arising out of usage fluctuations. Firms usually maintain some margin of safety or safety stocks. Two costs are involved in determination of this stock i.e., opportunity cost of stock-outs and carrying costs. The stock-outs of raw materials causes production disruption resulting into higher cost of production. Similarly, the stock-out of finished product result into the failure of the firm in competition, as the firm cannot provide proper customer service. If a firm maintains low level of safety, frequent stock-out will occur resulting into the large opportunity cost. On the other hand, the larger quantity of safety stock involves higher carrying cost.
3. Economic order quantity:

The exact quantity of any type of material to be purchased at a time is one of the fundamental problems faced by the purchase manager. The purchase of large quantity of material increases the carrying cost and the purchase of small quantity increases the ordering cost. Thus, economic order quantity is the quantity, which is most economic to order. It can be calculated with the help of following mathematical formula.

\[ E.C.Q. = \sqrt{\frac{2A.B}{C.S}} \]

Where,

- \( E.O.Q. \) = Economic Order Quantity
- \( A \) = Annual consumption in units.
- \( B \) = Buying cost per order.
- \( C \) = Cost per unit.
- \( S \) = Storage or carrying cost as a percentage of average stock.

4. ABC Analysis:

According to this technique of inventory control, inventory items are classified into three classes, i.e., A, B and C, basing upon their volume and cost significance. The number of items as well as the value of each class is expressed as percentage of the total. The following matrix illustrates the above classification.
<table>
<thead>
<tr>
<th>Class</th>
<th>No. of items (% of items)</th>
<th>Value of items (% of total value)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>10</td>
<td>70</td>
</tr>
<tr>
<td>B</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>C</td>
<td>70</td>
<td>10</td>
</tr>
</tbody>
</table>

From the above table it is clear that:

1. Items of high value but small in numbers are classified as 'A' items and concentrate more efforts for control.
2. Items of moderate value and moderate size are classified as 'B' items and moderate efforts are required for control.
3. Items of small value and large size are classified as 'C' items and less efforts required for control.

"The ABC plan concentrates on important items and known as control by importance and exceptions (CIE)."

5. VED Analysis:

Under VED classification the inventories are classified as vital, essential and desirable. This type of classification is applicable to spare parts and classified as vital spare parts, essential spare parts and desirable spare parts. There should be the provision of adequate stock of vital spares to ensure continuity in process of operation of the plant. However, in case of essential spares, moderate stock should be maintained and less stock in case of desirable spares.
6. **Inventory Turnover Ratio:**

Inventory turnover ratio is calculated to indicate whether inventories have been used efficiently or not. The purpose is to ensure the blocking of only required minimum funds in inventory. This ratio is also called the stock velocity. Inventory conversion period may also be calculated to find out the average time taken for clearing the stocks.

\[
\text{Inventory Turnover Ratio} = \frac{\text{Cost of Goods sold}}{\text{Average Inventory at Cost}}
\]

Or,

\[
\text{Inventory Conversion Period} = \frac{\text{Days in a year}}{\text{Inventory Turnover Ratio}}
\]

7. **Aging Schedule of Inventories:**

Classification of inventories according to the period of their holding also helps in identifying slow-moving inventories thereby helping in effective control and management of inventories.

<table>
<thead>
<tr>
<th>Item code</th>
<th>Age classification</th>
<th>Date of acquisition</th>
<th>Amount (Rs.)</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>001</td>
<td>0-15 days</td>
<td>25.06.2000</td>
<td>30,000</td>
<td>15</td>
</tr>
<tr>
<td>002</td>
<td>16-30 days</td>
<td>10.06.2000</td>
<td>60,000</td>
<td>30</td>
</tr>
<tr>
<td>003</td>
<td>31-45 days</td>
<td>20.05.2000</td>
<td>50,000</td>
<td>25</td>
</tr>
<tr>
<td>004</td>
<td>46-90 days</td>
<td>05.05.2000</td>
<td>40,000</td>
<td>20</td>
</tr>
<tr>
<td>005</td>
<td>61 days &amp; more</td>
<td>12.04.2000</td>
<td>20,000</td>
<td>10</td>
</tr>
<tr>
<td><strong>TOTAL:</strong></td>
<td></td>
<td></td>
<td><strong>2,00,000</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
8. Perpetual Inventory:

It is a system, in which the physical movements of stocks and their current balance is verified after each receipt and issue of the materials. It provides a basis for control by investing the discrepancies arising from the comparison of physical stock with book values. This system also reveals the existence of surplus, dormant, obsolete and slow-moving materials.

9. Periodical Inventory System:

Under this system, stock taking is undertaken at the end of the accounting year after making a physical verification of the quantity in hand. Periodical stocktaking usually necessitates the shutdown of the factory and as such, it should be completed as quickly as possible. This system of stock verification proves to be quite costly, because it involves stoppage of production activity. In addition, it is a weak system in view of the fact that, physical verification is done only after a gap of six months or a year and during the period, chances of detection of theft, pilferage, loss etc. are less.

10. Inventory Reports:

The management should be kept informed with the latest stock position of different items for effective inventory control. This is usually done by preparing periodical inventory reports. These reports should contain all information necessary for managerial action. On the basis of reports, management take corrective action whenever necessary.

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5.4 TECHNIQUES FOR MANAGING CASH

5.4.1 Cash is the most liquid asset and referred to as the lifeblood of a business. It is needed to acquire supplies, resources, equipments and other assets used in generating the production and services provided to the firm. It is also needed to pay wages and salaries to workers and managers, taxes to government, interest and principal to the creditors and dividend to the shareholders. Cash is the medium of exchange through which the various activities of the business carry day-to-day.

5.4.2 Therefore, the cash management is one of the key areas of working capital management. Cash management deals with the following:

a. Cash inflows and outflows.
b. Cash flows within the firm.
c. Cash balances held by the firm at a point of time by financing deficit or investing surplus cash.

5.4.3 The different processes or techniques for managing cash are discussed below.

1. Efficient inventory management: - We have already discussed about the processes or techniques of management of inventory in the previous section.
2. Speedy collection of accounts receivable: - A number of
methods may be employed to speed up the cash inflows and optimise available cash. The overall purpose of the various methods is to reduce the time lag between the moment a payment to the company is mailed and the moment of funds are ready for redevelopment by the company. These methods are:

a) Prompt payment by customers – The period of payment by which the customer has to pay, should be notified accurately and in advance. The use of mechanical devices for billing and the enclosure of a self-addressed return envelope will speed up payment by customers. Another technique to encourage prompt payment by customer is the practice of offering cash discount.

b) Quick deposit of customer’s cheques – One way of shortening the time lag between the date, when a customer signs a cheque and the date when the funds are available for use is to make an arrangement for quick deposit of the cheques in the banks the moments they are received special attention should be given to large remittances. For example, these may be deposited individually or airmail services should be used for such remittances.

c) Establishing collection centres – To accelerate the cash turnover, a nationwide organisation may instead of a single collection centre, establishing a number of collection centres in various marketing centres of the
country. The customers are requested to remitt their payments to the local collection centres and these centres deposit the cheques in the local bank. Surplus money of the local bank can be transferred to the company’s main bank.

d) Lock-box method – Under the lock-box system, firms hire a post office box at important collection centres. The customers are required to remit payments to the lock-box. The local banks of the firm, at the respective places, are authorised to open the box and pick up the remittances received from the customers.

3. Strategy towards slowing cash outflows:- In order to optimise cash availability in the company, finance manager must employ some devices that could slow down the speed of payments outward in addition to accelerating collection. We shall now discuss some of the important methods that may delay disbursements.

a) Delaying outward payment - By delaying the payment on bills until the last date of the no-cost period, finance manager can economise cash resources. If purchases are made in terms of 1/10, n/30, this method suggests that payment could be made on 10th day. In this way, the company not only avails of benefits of discount, but also releases funds for nine day for investment in short-term channels.
b) Slowing disbursement by use of drafts - At the time of cheque issued by the enterprise is presented to the bank, the firms' bank balance is reduced. Contrary to this, when draft is issued, the banks will not pay against the draft unless the bank gets the acceptance of the issuer firm. If term of trade is 2/10, a company can mail the draft to the supplier on the 10th day. The supplier will present the draft to his book for its presentation to the buying company's bank. It will take several days for the draft to be actually paid by the company.

c) Making payroll period less frequent - If the company is currently disbursing pay to its employees weekly, it can effect substantial cash savings if pay is disbursed only once in a month.

d) Paying the float - Float is the difference between the company's chequebook balance and the balance shown in the books of accounts of Bank. When the company writes a cheque, it will reduce the balance in its books of accounts by the amount of cheque. However, bank will debit the account of its customer only after a week or so when the cheque is collected. Thus, there is no wonder if the company's book shows a negative balance while the bank's books exhibit a positive balance.
5.5 PROCESS FOR MANAGING ACCOUNTS RECEIVABLE:

5.5.1 Accounts receivable represent the amount due from its customers to whom the company has extended the credit. In the modern world, the extension of credit is inevitable and most of the companies have to offer the credit to maintain the existing level of sales. Also to improve sales performance, the company may be required to change the terms of credit. For most of the companies, investment in accounts receivable constitute a major component. The prime goal of the receivables management is to formulate optimal credit policy for the firm to obtain optimum level of profits by increasing the volume of sales up to the level where costs of carrying receivables are kept at minimum level. Once the credit policy of a firm is decided, level of receivables will vary depending upon the volume of credit sales, which, in its turn, is conditioned by the general level of business activity and changes in the proportion of credit to cash sales.

5.5.2 Now, we discuss several ways of improving receivable turnover. This can be done by formulating suitable credit and collection policies and improving credit and collection procedures. In formulating credit and collection policies of a firm finance manager must consider the following aspects:
1. Credit standards:

Credit standards are the criteria, which a firm follows in selecting customers for the purpose of credit extension. The firm may extend credit only to the most reliable and financially strong customers. Such standards will result in non bad-debt losses, and less cost of credit administration. But the firm may not be able to expand sales. On the contrary, if the credit standards are loose, the firm may have larger sales. But the firm will have to carry larger receivables. So, while choosing the customers to whom the goods are to be sold on credit, the following points are to be considered.

(a) The time taken by customers to repay credit obligation, and average collection period.

(b) Default rate.

Average collection period determines the speed of payment by customers. It measures the number of days for which a credit sales remains outstanding. The longer the average collection period, the higher is the firm’s investment in receivables. Default rate can be measured in terms of bad-debt losses, ratio or proportion of uncollected receivable. In the other words, credit rating, credit reference, average payment period and certain financial ratios provide a quantitative basis for establishing and enforcing credit standards.
2. Credit period:

The credit period refers to the length of time for which customers are allowed to pay for their purchases. It generally varies from 15 days to 60 days. If a firm allows 30 days of credit, with no discount to induce early payments, its credit terms are stated as "net 30". Lengthening the credit period pushes sales up by inducing existing customers to purchase more and attracting new customers. However, lengthening the credit period involves cost. If the additional cost associated with lengthening credit period is less than the increased earnings, the finance manager should liberalise credit policy by increasing credit period.

3. Cash discount:

A company short of cash resources and facing liquidity problem may consider the use of cash discounts to influence its customers to pay promptly. There are two aspects of cash policy viz. cash discount rate and discount period. The finance manager should match the earnings resulting from investment of funds released by reducing the level of receivables with the cost of the discounts to decide whether cash discount should be offered or otherwise. Period of discount also influences average collection of receivables. Thus, by lengthening the discount period, many customers who were taking advantage of cash discount may be tempted to avail of this benefit.
4. Collection policy:

In addition to setting the credit standards, credit period, and cash discount policy, it is also important for the company to design the collection policy and procedures to speed up the collections as and when become due. The company can use number of methods to speed up the collections.

- Monitoring the state of receivables.
- Despatching the letters to customers whose due date is approaching.
- Telegraphic and telephonic advice to customers around the due date.
- Threat of legal action to overdue accounts.
- Legal action against overdue accounts.

5.6 STEPS FOR EFFECTIVE MANAGEMENT OF PAYABLES

5.6.1 A substantial part of purchases of goods and services in business are on credit terms rather than against cash payments. Payables constitute a current or short-term liability representing the buyer's obligation to pay a certain amount on a date in the near future for value of goods or services received. Those are the short-term delay of cash payments that the buyer of goods or services is allowed by the
The following steps are to be taken for effective management of payables.

1. Negotiate and obtain the most favourable credit terms like credit period, discount rate and discount period etc.

2. Where cash discount is offered for prompt payment, take advantage of the offer and derive the savings there from.

3. Where cash discount is not provided, settle the payable on its date of maturity and not earlier.

4. Do not stretch payables beyond due date, except in inescapable situations.

5. In highly competitive situations, suppliers may be willing to stretch credit limits and period. The finance manager should assess the bargaining strength of the company and get the best possible deal.

6. Avoid the tendency to divert payables. Maintain the self-liquidity character of payables and do not use the funds obtained there from for acquiring fixed assets.

7. Provide full information to suppliers and concerned credit agency to facilitate a frank and fair assessment of financial status and associated problems.

8. Keep a constant check on incidence of delinquency. Delays in settlement of payables with references to due dates can be classified into age groups to identify
delays exceeding one month, two months, three months etc. Once overdue payables are given priority of attention for payment, the delinquency rate can be minimised or eliminated together.

9. Sustain healthy financial status and a good track record of past dealings with the supplier such as to maintain his confidence.

5.7 WORKING CAPITAL MANAGEMENT UNDER INFLATION

5.7.1 Management of working capital under stable conditions is very easy, but it is very difficult in the unstable conditions like Indian economy. It is desirable to check the increasing demand of capital for maintaining the existing level of activity. Such a control acquires even more significance at the times of inflation. Inflation is the rise in general level of prices, or a fall in the purchasing power. In order to control working capital needs in periods of inflation, the following measures may be applied.

- The possibility of using substitute raw material without affecting quality must be explored. Research activities in this regard may be undertaken, with financial assistance provided by the government and the corporate sector, if any.
- Attempts must be taken for increasing productivity of work force by proper motivational strategies.
Before imposing any incentive plan for the labour force, the cost involved must be weighed against the benefit to be derived.

The managed costs like office-decorating expenses, advertising, managerial salaries and payments etc. should be properly scrutinised in terms of their costs and benefits.

The management should be vigilant in sanctioning any new expenditure.

If the span of operating cycle can be reduced, the increasing pressure to augment working capital will, to some extent, be neutralised. Greater turnover with shorter intervals and quicker realisation of debtors will go a long way in easing the situation.

A clear-cut policy regarding the disposal of slow-moving and obsolete stock must be formulated and adhered to.

There should be an efficient management information system reflecting the stock position from various standpoints.

5.8 SIGNIFICANCE OF WORKING CAPITAL MANAGEMENT

5.8.1 Working capital management is a significant part of business decisions. A firm is required to hold adequate amount of working capital to carry on its productive and distributive work smoothly. Thus, holding adequate amount of raw material in stock
ensure uninterrupted production activities. Likewise, sufficient stock of finished goods has also to be maintained in anticipation of future demand and for this purpose, the firms would need funds. Goods usually sold on credit and the firm arrange for funds to finance the amounts receivable for the period until they are collected. Along with this, a minimum level of cash is required for the ordinary operation of the enterprise for availing of the business opportunities. However, these assets will have to be maintained at appropriate level, because both surplus and shortage of working capital is detrimental to the financial health of an enterprise.

5.8.2 The finance manager is, therefore, in a dilemma between liquidity and profitability. An efficient financial manager has to manage working capital in such a way as to maximise profitability of the firm without impairing its liquidity. "Liquidity is a matter of degree. A lack of liquidity implies a lack of freedom of choice as well as constraints on management’s freedom of movement". Therefore, working capital management is particularly more important to small firms. "A small firm may reduce its fixed assets requirement by renting or leasing plant and equipments, but there is no way to avoid an investment in current assets. The financial manager should, therefore, devote considerable time to manage current assets".

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5.9 SUMMARY

5.9.1 Working capital management is considered as the administration of current assets and current liabilities. On the other hand, administration of fixed assets comes under the scope of capital budgeting. The firm should determine its different levels and composition of current assets to maintain a sound working capital position. Therefore, the financial executive should keep an eye on the management of investment in current assets, financing the working capital, inter-relatedness and volatility and reversibility.

5.9.2 Every enterprise needs inventory for smooth running of business. Because, inventory serves as a link between production and distribution processes. The inventory shows control efficiently for avoiding unnecessary investments in them. The important tools and techniques for managing inventory are setting different stock level, EOQ, ABC analysis, VED analysis, inventory turnover ratio etc.

5.9.3 Cash is the most liquid asset and lifeblood of the business. Therefore, the cash management is one of the key areas of working capital management. For efficient management of cash, the techniques of efficient inventory management, speed collection of accounts receivable, slowing cash outflows etc. should be followed.
5.9.4 Investment in accounts receivable constitute a major component for most of the companies. The primary goal of the receivables management is to formulate optimal credit policy for the firm to get maximum profits by increasing the volume of sales. The finance manager must decide credit standards, credit periods, cash discount and collection policies for formulating the credit and collection policies of a firm. Payables also plays substantial role in the management of working capital of a business. It constitutes a current or short-term liability. Credit period, discount rate and discount period are considered to be the important policies for the effective management of payables.

5.9.5 Inflation magnifies the need for working capital. The constant rise in the cost of inputs, if not accompanied with corresponding increase in output prices, puts an additional strain for the management. However, by taking several measures on production front and by keeping a strict watch on managed costs and expediting collection of credit sales, etc., the management can check or at least minimise the upward thrusts for additional working capital.

5.9.6 In a developing country like India, the manner of administration of working capital will determine to a very large extent the success or failure of overall operations of an enterprise. A firm/enterprise requires to hold adequate amount of working capital to carry on its productive and distributive work smoothly,
whereas shortage of this is detrimental to its financial health. The finance manager, is therefore, in a dilemma between liquidity and profitability. However, an efficient management of working capital maximising profitability of the firm without impairing its liquidity.

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4. Richmond, Herbert J., “Effective Inventory Management-Fact or Fiction?” Financial Executive (March 1969, PP 74-78.)
