CHAPTER 6

FINANCING THE WORKING CAPITAL

6.1 Introduction
6.2 Sources of Working Capital Finance
6.3 Determination of Financial Mix
6.4 Financing the Working Capital and Bank Policy
6.5 Sources of Gross Working Capital
6.6 Pattern of Financing
6.7 Trade Credit
6.8 Financing the Working Capital
6.9 Summary
6.1 INTRODUCTION:

6.1.1 After determination of current assets in the aggregate and various components of working capital, the next important task before a financial manager is to select an assortment of appropriate sources to finance current assets. A business firm has different sources to meet its financial requirements. To select a particular source, a finance manager has to consider the merits and demerits of same in the context of the constraints of the firm. The need of working capital increases due to the rise in the prices of the end products and relative inputs. On the other hand, the government and monetary authorities play their own role in the periods of inflation. Control measures often take the firm to dear monetary policy and restrictive credit. Financing of additional working capital requirements in such an environment is a real problem for the finance manager of a unit.

6.1.2 Commercial banks play the most significant role in providing working capital finance. In view of mounting inflation, the Reserve Bank of India has adopted certain fiscal measures to check the money supply in the economy. The balancing need has to be managed either by long-term borrowings or by issuing equity or by earning sufficient profits and retaining the same for coping with the additional working capital requirements.
6.2 SOURCE OF WORKING FINANCE:

6.2.1 A business organisation has different sources of finance to meet the working capital. For choosing a particular source, the pros and cons of the same is evaluated in the context of the constraints of a firm. "Without proper finance there will be no efficient planning, nor purchase of materials, nor production, nor marketing, nor any fair profit; the later in its turn forming the foundation of the finance itself".

6.2.2 On the basis of time, the sources of finance of a firm in an industry is classified into two categories, long-term resources and short-term resources. Each of these can further be divided into internal and external sources as follows.

1. Long term internal sources:
   (i) Retained earning, and
   (ii) Depreciation provisions

2. Long-term external sources:
   (i) Equity capital
   (ii) Debentures, and
   (iii) Long-term loans from financial institutions including commercial banks.
3. Short-term internal sources:
   (i) Dividend provision, and
   (ii) Tax provision.

4. Short-term external sources:
   (i) Trade credit,
   (ii) Bank credit,
   (iii) Public deposits,
   (iv) Commercial papers, and
   (v) Misc. sources such as deposits from stockist and contractors etc.

6.2.3 We can discuss the sources of working capital in other way. In all the concerns, a part of the working capital investments are as permanent investments as in fixed assets. This is so because the minimum amount, which is required to ensure the effective utilisation of fixed facilities and for maintaining the circulation of fixed assets. This minimum level of current assets is called permanent or fixed working capital, as this part of capital is permanently blocked in current assets. Similarly, some amount of working capital required to meet the seasonal demands and some special exigencies; such as rise in prices, strikes etc., which is called as temporary working capital. As observed by financial experts like Robert H. Wessel, “permanent working capital should be financed by equity capital or other long-term sources, where as temporary working capital should generally be financed by short term sources”.  
106
A. Financing of permanent working capital:

Permanent working capital should be financed in such a manner that the enterprise may have its uninterrupted use for a long period. There are five important sources of permanent or fixed working capital.

i) Issue of share capital – This is the most important sources for raising the permanent or fixed working capital. Companies can issue different types of shares, like equity shares and preference shares to mop up funds from various investors. Some investors prefer regular income though it may be low, others may prefer higher returns and they will be prepared to take risk. So, different types of shares suit different types of investors. If only one type of shares are issued, the company may not be able to mop up sufficient funds.

ii) Issue of debentures – A company may raise long-term finance through public borrowings. The issue of debentures raises those loans. A debenture is an acknowledgement of a debt. According to Thomas Evelyn “A debenture is a document under the company’s seal which provides for the payment of a principal sum and interest thereon at regular intervals, which is usually secured by a fixed or
floating charge on the company’s property or undertaking and which acknowledges a loan to the company. A debenture-holder is a creditor of the company. A fixed rate of interest is paid on debentures and also debentureholders are paid on priority in comparison to all other creditors at the time of liquidation of the company.

iii) Public deposits or fixed deposits – Another way of raising long-term funds by a company is to invite public deposits for a specified period at a fixed rate of interest. Usually, companies inviting public deposits, pay a higher rate of interest than the commercial banks for a similar period. Public deposits as a source of finance have large number of advantages i.e., no legal formalities required, more rate of interest, taxation benefits, trading on equity, no need of securities and inexpensive source of finance.

iv) Loans from financial institutions – Another important source of raising finance is form the financial institutions like IFCI, IDBI, ICICI, SFCs, commercial banks etc. Such organisations provide medium and long-term loans on easy instalments to big industrial houses. The advantages of these loans are requirement of reasonable security, availability of finance during periods of depression, easy repayment facility, underwriting facility etc. Such
institutions help in promoting new companies; expansion and development of existing companies and meeting the financial requirements of companies during economic depression.

v) Ploughing back of profits – This concept in financial management means that out of the total profits of a company in a particular year, a certain part is retained and that amount is reinvested or re-employed into the business. The remaining part of the profits is distributed by way of dividend to the shareholders. It is an internal source of finance and is the most suitable for an established firm for its expansions, modernisations, and replacements etc. This method of finance has a number of advantages as it is very economical method of financing, aids in capital formation, it is cheaper rather cost free sources of finance, no need to keep securities, there is no dilution of control etc.

B. Financing of Temporary Working Capital:

The main sources of short-term working capital are as follows:

1) Bank credit – Bank finance is an important source for financing the current assets of a company. It is available in different forms. Bankers are guided by the credit worthiness of the customer, the
form of security offered and the margin requirement on the assets provided as security. Both direct and indirect form of bank finance, is briefly outlined below:

a) **Cash credit:** Under the cash credit arrangement, the customer is permitted to borrow up to a prefixed limit called the cash credit limit. The customer is charged interest on the amount actually utilised, subject to some minimum services charge or maintaining some minimum balance, also known as compensatory balance in the cash credit account. The security offered by the customer is in the nature of hypothecation or pledge.

b) **Overdraft:** Overdraft arrangement is similar to the cash credit arrangement. Under the overdraft arrangement, the customer is permitted to overdraw up to a prefixed limit. Interest is charged on the amounts overdrawn subject to some minimum charge as in the case of cash credit arrangement. The drawing power is also determined as in the cash credit. Overdraft account operates against security in the form of pledge, share and securities, assignment of life insurance policies and sometimes even mortgage of fixed assets. Overdraft is more permanent than long-term loans sanctioned by financial institutions like IDBI.
c) **Loan arrangement:** - When a bank gives an advance in lump sum against some securities is called loans. In case of loan, the bank sanctioned a specific amount to its customers. The borrower is required to pay interest on the entire amount of the loan from the date of sanctions. In case of the loans, it is repaid in instalment, interest is payable on actual balance outstanding.

d) **Purchasing or discounting the bills:** - Under this arrangement, the bank provides finance to the customer either by outright purchasing or discounting the bills arising out of sale of finished goods. Obviously, the bank will not pay the full amount but provides credit after deducting its charges. To be on the safe side, the banker will scrutinize the authenticity of the bill and creditworthiness of the concerned organizations besides covering the amount under the cash credit or overdraft limit.

e) **Term loans:** - Under this arrangements banks advance loans for three to seven years repayable in yearly or half-yearly instalments. The banker can not afford to take the risk of non-recovery of money lent. In case of borrower’s inability to pay, the banker must have some tangible assets to fall back upon. The banker, therefore, tries to get some charge created on the assets of the borrower in its favour. Such charge makes the
asset charged available to the banker, when needed in satisfaction of the advances made by it. Some of the modes by which such charges can be created are:

1. **Lien:** Lien is the right of a person to retain that, which is in his possession and which belongs to another until the demands of the person in possession are satisfied. Lien gives to a person only a right to retain the possession of goods and not the power to sell unless such a right is expressly conferred by statute. There are two kinds of lien, i.e. particular lien and general lien. Particular lien is a right to retain goods until a claim pertaining to these goods is fully paid. On the other hand, general lien can be applied till all dues of the claimant are paid. Banks enjoy the general lien.

2. **Pledge:** Pledge is the bailment of goods as security for payment of a debt or performance of a promise. Bailor in this case is called 'Pawner' and the bailee is called 'Pawnee'. In a contract of pledge Pawner must deliver the goods pledge to the Pawnee either actually or constructively. Transfer of possession, in the judicial sense, is essential in a valid pledge. Only movable goods can be pledged. It must take
reasonable care of goods pledged with it. The term "reasonable care" means care, which a prudent person would take to protect his property. He would be responsible for any loss or damages, if he uses the pledged goods for his own purposes. In case of non-payment of the loans, the bank enjoys the right to sell the goods.

iii) Hypothecation: Under this mode of security, the bank provides credit to borrower against the security of movable property, usually inventory of goods. It is different from pledge because the asset pledged remains in the possession of the lender. However, the hypothecation deeds usually provide that the banker will have the power to take goods hypothecated in its possession if the need arises. Although the bank does not have physical possession of the goods, it has legal right to sell the goods to realise the outstanding loans.

iv) Mortgage: It is the transfer of an interest in specific immovable properties for the purpose securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or the performance of an engagement, which may give
rise to pecuniary liability. The transferor is called mortgager and the transferee is mortgagee. The principal money and the interest of which payment is secured for the time being are called the mortgage money and the instrument by which the transfer is affected is called mortgage deed.

II. Trade credit: As present day, commerce is built upon credit; the trade credit arrangement of a concern with its supplier is an important source of short-term finance. “According to an estimate, trade credit and bank credit together finance about 3/4th of the working capital requirement of the industry”\(^3\).

Determinants of the volume of trade credit.

a) Availability of other finance.
b) General shortage of capital.
c) Credit stringency.
d) Status of credit givers.
e) Size of financial resources.

III. Other current liabilities: Current liabilities those are neither bank credit nor trade credit belongs to this group.
The items included for this purposes are:

a) Advance from customers.

b) Outstanding expenses like salaries, wages and other expenses

c) Statutory liabilities like provisions for sales tax, income tax and dividend.

d) Others, e.g. advances from employees and directors, deposit of temporary in nature, etc.

6.3 DETERMINATION OF FINANCIAL MIX

6.3.1 Apart from the profitability risk trade-off, another important ingredient of the theory of working capital is determining the financial mix. The firm must find out the sources of funds to finance its current assets. It can adopt different financing policies. There are broadly, three types of financing;

i) Long-term financing

ii) Short-term financing and

iii) Spontaneous financing

6.3.2 The important sources of long-term financing are shares, debentures, preference shares, retained earnings and debt from financial institutions. Short-term financing refers to those sources of short-term credit, which the firm must arrange in
advance. These sources include short-term bank loans, commercial papers and factoring receivables. Spontaneous financing refers to the automatic sources of short-term funds. The major sources of such financing are trade credit (creditors and bills payable) and outstanding expenses. Such sources of financing are cost free.

6.3.3 There are three basic approaches to determine an appropriate financing mix. They are

1. Hedging or Matching approach
2. Conservative approach
3. Aggressive approach.

1. **HEDGING OR MATCHING APPROACH**

The term "hedging" is often used in the sense of risk reducing investment strategy, involving transactions of simultaneous but opposite nature, so that the effect of one is likely to counter balance the effect of other.

According to this approach, the firm can adopt a financial plan, which involves the matching of the expected life of assets with the expected life of the source of funds raised to finance assets. For the purpose of analysis, the assets can broadly classified into two classes.

a. Those, which are required in a certain amount for a given level of operations and hence do not vary over time.
b. Those, which are, fluctuate over time.

According to this approach, the permanent portion of funds required should be financed with long-term funds and the seasonal portion with short-term funds. With this approach the short-term financing requirement (current assets) would be just equal to the short-term financing available i.e, current liabilities.

2. CONSERVATIVE APPROACH

This approach suggests that the estimated requirement of total trends should be met from long-term sources; the use of short-term funds should be restricted to only emergency situation or when there is an unexpected outflow of funds. The firm actually has excess liquidity during the lower ebb of its assets cycle and thus, faces a lower risk of being caught short of cash than a firm that follows the pure hedging approach. However, the firm also increases its investment in relatively low-yielding assets such that its return on investment is diminished.

3. AGGRESSIVE APPROACH-

A firm may be aggressive in financing its assets. An aggressive policy is said to be followed by the firm, when it uses more short-term financing than warranted by the matching plan. Under the aggressive policy, the firm finances a part of its
permanent current assets with short-term financing. Some extremely aggressive firm may even finance a part of their fixed assets with short-term financing. The relatively more use of short-term financing makes the firm more risky.

6.4 FINANCING WORKING CAPITAL AND BANK POLICY.

6.4.1 Bank finance is an important source of financing the current assets of companies. The banking sector provides the funds so long as there is adequate security for the funds lent. In the wake of nationalisation of major banks in 1969, the banking sector had been called upon to act as catalyst in the overall development of different sectors of the society. The development potential approach had to be adopted by the banking sector, in place of security oriented approach. Consequently, the demand on bank finance had gone up considerably. In the divergent potential approach, the banks are taking the following steps:

a. Cash credit and overdraft system to favour borrowers.

b. Banks provide financial assistance to weaker sections of the society, who may not be in a position to provide security.

c. Large and medium borrowers abused bank finance to require stock much more than warranted by the
production programmers and to divert funds for other uses unrelated to working capital.

6.4.2 To regulate and control bank finance the Reserve Bank of India has been issuing direction and guidelines to the banks from time-to-time as the recommendations of specially constituted committees, which are entrusted with the task of examining various aspects of bank finance to industry. In this context, we propose to discuss the important findings and recommendations of the following committees.

DEHEJA COMMITTEE REPORT

National Credit Council constituted a Study Group under the Chairmanship of Sri V.T Deheja in Oct. 1968 to examine the subject of the extent to which credit needs to industry and trade are likely to be inflated and how such trends could be checked. The Group submitted its report in September 1969.

Major Findings:

1. The bank credit during the period from 1960-61 to 1966-67 expanded at a higher rate than the rise in industrial output. From 1961-62 to 1966-67, the rise in the value
of inventories in the industry was 80 percent, while rise in the short-term bank credit was 130 percent.

2. The banks fix credit units on the basis of working of the loanee concerns, such as production, sales, inventory levels, past utilisation etc.

3. Banks did not generally adopt a uniform method of valuation of stocks.

4. A study of 255 companies over the period from 1961-62 to 1966-67 showed deterioration in their current ratio and the increase in short-term liabilities was utilised for financing the gap between long-term assets and long-term liabilities.

Suggestions:

(1) The appraisal of credit applications should be made with reference to the total financial situations existing and projected, as shown by cash flow analysis and forecast submitted by borrowers.

(2) The outstanding in the existing as well as further cash credit accounts should be distinguished as between (i) 'hard-core' which would represents the minimum level of raw-materials, finished goods and stores which the industry was required to hold for maintaining given level
of production and (ii) the strictly short-term component which would be the fluctuating part of the account. The latter part of the account would represent the requirements of the funds for temporary purchases e.g. short-term increase in inventories, tax, dividend and bonus payments etc, the borrowing being adjusted in a short period out of sales.

(3) Double or multiple financing may result where credit facilities are granted against receivables either by way of documents against acceptance of bills or drawing against book debts; the purchase is also in a position to obtain bank credit by way of hypothecations/pledge of the stocks which have not been paid for.

(4) Trade credit should not exceed 60 days and in special circumstances up to 90 days (excluding sales of capital equipment on deferred payment terms).

(5) The Group suggested adequate attention should be paid for the adequacy of the inventories in different industry.

TONDON STUDY GROUP

The Reserve Bank of India constituted a Study Group in July 1974, to frame guidelines for follow up of bank credit under the Chairmanship of Sri Prakash Tondon. The term of reference of the Group were:
i. To suggest guidelines for commercial bank to follow-up and supervise credit from point of view of ensuring proper end-use of funds and keeping a watch on the safety of the advances.

ii. To make recommendation for obtaining periodical forecasts from the borrowers of (a) business/production plans (b) credit needs

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

iv. To suggest criteria regarding satisfactory capital structure and sound financial basis in relation to borrowing.

v. To make recommendations regarding the sources for financing the minimum working capital requirements.

vi. 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.

vii. To make recommendations on any other related matter as 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.
Suggestions and Recommendations

The committee was of opinion that:

(i) Bank credit is extended on the amount of security available and not according to the level of operations of the customer; (ii) bank credit instead of being taken as a supplementary to other sources of finance.

The committee recommended the continuation of existing cash credit system. The recommendations of the committee regarding lending norms have been suggested under these alternatives. According to first method, the borrower will have to contribute minimum 25 percent of the working capital gap form long-term funds i.e. owned funds and term borrowing; this will have minimum current ratio of 1.17:1. Under the second method, the borrower will have to provide minimum of 25 percent of the total current assets from long-term funds; this will gave a minimum current ratio of 1.33:1. In the third method, the borrower’s contribution from long-term funds will be to the extent of the entire core current assets and a minimum of 25 percent of the balance current assets, this strengthening the current ratio further.
The Reserve Bank of India in March 1979 appointed another committee under the Chairmanship of Sri K.B.Chore to review the system of credit in all aspects. The term of reference of the Working Group were as follows:

1. To review the operation of the cash credit system with reference to the gap between sanctioned credit limits and the extents of their utilisation.

2. In the light of the review, to suggest;
   a. modifications in the system with a view to making the system more amenable to rational management of funds by commercial banks,
   b. and/or 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 production activities.

3. To make recommendations on any other related matter as the Group may concern to the subject.

The Group made following recommendation in its final report.

i. The banks should obtain quarterly statements in the prescribed format from all borrowers having working capital credit limits of Rs. 50 lakhs and above.
ii. The banks should undertake a periodical review of limits of Rs 10 lakhs and above.

iii. The bank should not bifurcate cash credit accounts into demand loans and credit components.

iv. If a borrower does not submit the quarterly returns in time the banks may charge penal interests of one percent on the total amount outstanding for the period of default.

v. Banks should discourage sanction of temporary limits by charging additional one percent interest over the normal rate on these limits.

vi. The banks should fix separate credit limit for peak level and non-peak level, wherever possible.

vii. Banks should take steps to convert cash credit limits into bill limits for financing sales.

MARATHE COMMITTEE REPORT

The Reserve Bank of India, in 1982, appointed a committee under the Chairmanship of Marathe to review the workings of Credit Authorisation Scheme (CAS) and suggest measures for giving meaningful directions to the credit management function of the Reserve Bank. The Reserve Bank of India with minor modifications has accepted the recommendations of the Committee.
1. The Committee has declared the third method of lending as suggested by the Tondon Committee report to be dropped. Hence, in future, the banks would provide credit for working capital according to Second Method of Lending.

2. The committee has suggested the introduction of the “First Track Scheme” to improve the quality of credit appraisal in banks. It recommended that commercial banks can release without prior approval of Reserve Bank 50 percent of the additional credit required by the borrower (75 percent in case of export oriented manufacture also) where the following requirement are fulfilled.

   a. estimates/projections in regard to production, sales, chargeable current assets, other current assets, current liabilities, other than bank borrowers, and net working capital are reasonable in terms of past trends and assumptions regarding most likely trends during the future projection period.

   b. The classification of assets and liabilities as “current” and “non-current” is in conformity with his guidelines issued by the Reserve Bank of India.

   c. The projected current ratio is not below 1.33:1.

   d. The borrower has been submitting quarterly information and operating statements (Form I, II, III) for the past six months within the prescribed time and undertakes to do the same in feature also.
The borrower undertakes to submit to the bank his annual account regularly and promptly. Further, the bank is required to review the borrower's facilities at least once in a year, even if the borrower does not need enhancement in credit facilities.

CHAKARVORTY COMMITTEE REPORT:

The Reserve Bank of India appointed another committee under the Chairmanship of Sukhamoy Chakraborty to review the working of the monetary system of India. The committee submitted its report in April 1985. The committee made two major recommendations in regard to the working capital finance.

(I) Penal Interest for Delayed payment.

The committee has suggested that the government must insist that all public sector units, large private sector units and government departments must include penal interest payment clause in their contracts for payments delayed beyond a specified period. The penal interest may be fixed at 2 percent higher than the minimum lending rate of supplier's bank.
(II) Classification of credit limits under three different heads.

The Committee further suggested that the total credit limit to be sanctioned to a borrower should be considered under three different heads.

1. Cash credit I to include suppliers to government.
2. Cash credit II to cover special circumstances,
3. Normal working capital limit to cover the balance credit facilities.

The interest rates proposed for these heads are different. Basic lending rate of the bank should be charged to cash credit II, and normal working capital limit be charged as below:

(a) For cash credit portion: Maximum preventing lending rate of the bank.
(b) For Bill finance portion: 2 percent below the basic lending rate of the bank.
(c) For loan Portion: the rate may vary between the minimum and maximum lending rate of the bank.

6.5 SOURCES OF FINANCING GROSS WORKING CAPITAL

6.5.1 Table 6.1 gives an idea about the different sources of financing the gross working capital during the study period. The
source of financing includes short-term and long-term financing. The share of short-term finance is 33.9 percent, where as that of long-term finance is 66.1 percent in financing gross working capital. Short-term financing includes sundry creditors, bank loans and other current liabilities. From the table, it can be observed that, sundry creditors constituted 14.4 percent of the total short-term financing. In the year 1991-92, it was Rs 296.2 crores, whereas it was Rs 812.7 crores in 2002-03, an increase of 274 percent over the period of study. Bank loans provides minimum amount of finance to gross working capital of the industry. It constituted 7.3 percent of the total short-term finance. Like sundry creditors, the volume of bank loans available in the first year of the study i.e. in the year 1991-92 was Rs 111.8 crores. This is increased to Rs 528.9 crores in the year 2002-03, increasing 473 percent. Thus, the industry increased its dependence in bank loans for getting short-term finance as in the case of sundry creditors.

6.5.2 Other current liabilities, excluding creditors and bank loan, had a share of 12.2 percent in the total finance available for financing the gross working capital. The average volume of other current liabilities as a short-term source was Rs 231.4 crores in the year 1991-92 and it was increased to Rs 720.2 crores in 2002-03 at 311 percent. Therefore, other current liabilities also played a significant role in providing short-term finance to the sample
companies. Reserve and surplus and long-term loans provide a large amount of finance to gross working capital of the industry. From table 6.1, we observed that, the share of this in financing gross working capital was 66.1 percent during the period. The volume of Reserve & Surplus and long-term loans was Rs 1129.9 crores in 1991-92 and Rs 2282.1 crores in 2002-03 at an increase of 202 percent. Overall, we noticed that, the share of sundry creditors fluctuated between 9.2 percent and 18.7 percent, bank loans varied between 3.0 percent and 12.3 percent, while, other current liabilities varied between 8.5 percent and 16.9 percent. All the short-term, taken together, varied between 23.9 percent and 47.5 percent. The share of long-term loans and reserves and surpluses of the industry varied between 52.5 percent and 76.1 percent during the period of our study.

6.6 PATTERN OF FINANCING WORKING CAPITAL

6.6.1 Table 6.2 provided the Pattern of financing of gross working capital of the Aluminium Industry of India. In connection to growth period of gross working capital and sales, we observed that, out of eleven years, the gross working capital is higher than sales in 1993-94, 94-95 and 97-98. At first, the two sources, viz. sundry creditors and other current liabilities together form the non-bank current liabilities. The gross working capital minus
### TABLE 6.1

**SOURCES OF FINANCING THE GROSS WORKING CAPITAL**

(Rs. In Crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Working Capital</th>
<th>Bank Loan</th>
<th>Sundry Creditors</th>
<th>Other Current liabilities</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>%</td>
<td>Total</td>
<td>%</td>
<td>Total</td>
</tr>
<tr>
<td>1991-92</td>
<td>1769.3 (100)</td>
<td>111.8 (6.3)</td>
<td>296.2 (16.7)</td>
<td>231.4 (13.1)</td>
<td>639.4 (36.1)</td>
</tr>
<tr>
<td>1992-93</td>
<td>2071.1 (100)</td>
<td>137.8 (6.6)</td>
<td>332.6 (16.1)</td>
<td>260.7 (12.6)</td>
<td>731.1 (35.3)</td>
</tr>
<tr>
<td>1993-94</td>
<td>2240.6 (100)</td>
<td>97.4 (4.3)</td>
<td>316.0 (14.1)</td>
<td>247.9 (11.1)</td>
<td>661.3 (29.5)</td>
</tr>
<tr>
<td>1994-95</td>
<td>2784.8 (100)</td>
<td>170.2 (6.1)</td>
<td>375.0 (13.5)</td>
<td>327.7 (11.8)</td>
<td>872.9 (31.4)</td>
</tr>
<tr>
<td>1995-96</td>
<td>2834.5 (100)</td>
<td>201.1 (6.8)</td>
<td>363.0 (12.4)</td>
<td>248.8 (8.5)</td>
<td>812.9 (27.7)</td>
</tr>
<tr>
<td>1996-97</td>
<td>3193.4 (100)</td>
<td>217.6 (6.9)</td>
<td>372.2 (11.6)</td>
<td>376.8 (11.8)</td>
<td>966.6 (30.3)</td>
</tr>
<tr>
<td>1997-98</td>
<td>3673.3 (100)</td>
<td>111.2 (3.0)</td>
<td>339.9 (9.2)</td>
<td>428.7 (11.7)</td>
<td>879.8 (23.9)</td>
</tr>
<tr>
<td>1998-99</td>
<td>3617.7 (100)</td>
<td>135.0 (3.7)</td>
<td>378.0 (10.4)</td>
<td>444.6 (12.3)</td>
<td>957.6 (26.4)</td>
</tr>
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<td>1999-00</td>
<td>3148.8 (100)</td>
<td>224.4 (7.1)</td>
<td>470.1 (14.9)</td>
<td>279.3 (8.9)</td>
<td>1442.7 (30.9)</td>
</tr>
<tr>
<td>2000-01</td>
<td>3136.2 (100)</td>
<td>341.1 (10.9)</td>
<td>572.4 (18.2)</td>
<td>529.2 (16.9)</td>
<td>1442.7 (46.0)</td>
</tr>
<tr>
<td>2001-02</td>
<td>3323.8 (100)</td>
<td>370.8 (11.2)</td>
<td>590.6 (17.8)</td>
<td>323.7 (9.7)</td>
<td>1285.1 (38.7)</td>
</tr>
<tr>
<td>2002-03</td>
<td>4343.9 (100)</td>
<td>528.9 (12.2)</td>
<td>812.7 (18.7)</td>
<td>720.2 (16.6)</td>
<td>2061.8 (47.5)</td>
</tr>
</tbody>
</table>

| Figures for the study period | 36237.4 (100) | 2647.3 (7.3) | 5218.7 (14.4) | 4419.0 (12.2) | 12285.0 (33.9) | 23952.4 (66.1) |

N.B. Figures denote in parantheses are in percentages.
total non-bank current liabilities represents working capital gap. This working capital gap is partly met by short-term bank borrowings, the balance being supported by reserves and surpluses and long-term loans. The position, which is supported by reserves & surpluses and long-term loans, known as net working capital.

6.6.2 As a source of working capital finance, sundry creditors showed an increasing trend during the period of study. It had grown in the later part of study i.e. from 1997-98 to 2002-03 at a faster rate. The higher rate of sundry creditors could have occurred, due to postpone of payments because of financial pressure. Other current liabilities were also in an increasing trend. The growth trend showed 311 in 2002-03 as against 100 in 1991-92.

6.6.3 The growth trend of short-term bank borrowings shows that, it increased at a faster rate than that of sales. In the later part of out study i.e. from 1997-98 to 2002-03, it increased at a faster rate. In the case of reserves and surpluses and long-term loans, showed the increasing trend during the period of study. As compare to short-term bank borrowings it always higher except in the year 1992-93, 1999-2000, 2000-01, 2001-02 and 2002-03.
### TABLE 6.2

**PATTERN OF FINANCING FOR WORKING CAPITAL**

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>100</td>
<td>123</td>
<td>124</td>
<td>154</td>
<td>188</td>
<td>187</td>
<td>206</td>
<td>207</td>
<td>249</td>
<td>275</td>
<td>272</td>
<td>408</td>
</tr>
<tr>
<td>Gross Working capital (GWC)</td>
<td>100</td>
<td>117</td>
<td>127</td>
<td>157</td>
<td>166</td>
<td>180</td>
<td>208</td>
<td>204</td>
<td>178</td>
<td>177</td>
<td>188</td>
<td>245</td>
</tr>
<tr>
<td>Financed by:</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Sundry Creditors</td>
<td>100</td>
<td>112</td>
<td>107</td>
<td>127</td>
<td>123</td>
<td>126</td>
<td>115</td>
<td>128</td>
<td>159</td>
<td>193</td>
<td>199</td>
<td>274</td>
</tr>
<tr>
<td>b) Other Current Liabilities</td>
<td>100</td>
<td>113</td>
<td>107</td>
<td>142</td>
<td>108</td>
<td>163</td>
<td>185</td>
<td>192</td>
<td>121</td>
<td>229</td>
<td>140</td>
<td>311</td>
</tr>
<tr>
<td>Total Non-bank Short-term liabilities (Total of a+b)</td>
<td>100</td>
<td>112</td>
<td>107</td>
<td>133</td>
<td>116</td>
<td>142</td>
<td>146</td>
<td>156</td>
<td>142</td>
<td>209</td>
<td>173</td>
<td>290</td>
</tr>
<tr>
<td>Working Capital Gap (GWC-Non-bank C.L.)</td>
<td>100</td>
<td>119</td>
<td>135</td>
<td>168</td>
<td>187</td>
<td>197</td>
<td>234</td>
<td>225</td>
<td>189</td>
<td>163</td>
<td>194</td>
<td>226s</td>
</tr>
<tr>
<td>Met by: Short-term bank borrowings</td>
<td>100</td>
<td>123</td>
<td>87</td>
<td>152</td>
<td>180</td>
<td>195</td>
<td>99</td>
<td>121</td>
<td>201</td>
<td>305</td>
<td>332</td>
<td>473</td>
</tr>
<tr>
<td>Net Working Capital met from reserve and surpluses and long-term loans</td>
<td>100</td>
<td>119</td>
<td>140</td>
<td>169</td>
<td>188</td>
<td>197</td>
<td>247</td>
<td>235</td>
<td>192</td>
<td>150</td>
<td>180</td>
<td>202</td>
</tr>
</tbody>
</table>
6.7 TRADE CREDIT

6.7.1 The use of trade credit has an important role in the financing of working capital. The trade credit can be divided into two groups i.e. "sundry creditors" and "sundry debtors". Both are short-term in nature. The volume of sundry debtors dominated the sundry creditors in all the years of the study period except in the year 2002-03. The volume of sundry debtors increased from Rs 484.6 crores in the year 1991-92 to Rs 788.0 crores in the year 2002-03. While the volume of sundry creditor increased from Rs 292.2 crores to Rs 812.7 crores during the period. So, we observed, both sundry debtors and sundry creditors increased over the period. The annual growth rate of sundry creditors exceeds that of sundry debtors. It indicates that the industry is relying more on sundry creditor's support for financing its short-terms needs. The table 6.3 shows the volume of sundry debtors more than sundry creditors. On an average, the volume of sundry creditors was 65.8 percent of sundry debtors during the period.
### TABLE 6.3

**POSITION OF TRADE CREDIT OF ALUMINIUM INDUSTRY OF INDIA**

for the period from 1991-92 to 2002-03

(Rs in crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Sundry Debtors</th>
<th>Sundry Creditors</th>
<th>Annual growth rate of S. Drs</th>
<th>Annual growth rate of S. Crs</th>
<th>S. Crs as a percentage of S.Drs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>484.6</td>
<td>292.2</td>
<td>-</td>
<td>-</td>
<td>61.1</td>
</tr>
<tr>
<td>1992-93</td>
<td>625.0</td>
<td>332.6</td>
<td>29.0</td>
<td>12.3</td>
<td>53.2</td>
</tr>
<tr>
<td>1993-94</td>
<td>490.4</td>
<td>316.0</td>
<td>(21.5)</td>
<td>(5.0)</td>
<td>64.4</td>
</tr>
<tr>
<td>1994-95</td>
<td>503.1</td>
<td>375.0</td>
<td>2.6</td>
<td>18.7</td>
<td>74.5</td>
</tr>
<tr>
<td>1995-96</td>
<td>795.2</td>
<td>363.0</td>
<td>58.1</td>
<td>(3.2)</td>
<td>45.6</td>
</tr>
<tr>
<td>1996-97</td>
<td>782.0</td>
<td>372.2</td>
<td>(1.7)</td>
<td>2.5</td>
<td>47.6</td>
</tr>
<tr>
<td>1997-98</td>
<td>806.3</td>
<td>339.9</td>
<td>3.1</td>
<td>(8.7)</td>
<td>42.2</td>
</tr>
<tr>
<td>1998-99</td>
<td>788.8</td>
<td>378.0</td>
<td>(2.2)</td>
<td>11.2</td>
<td>47.9</td>
</tr>
<tr>
<td>1999-00</td>
<td>672.1</td>
<td>470.1</td>
<td>(14.8)</td>
<td>24.4</td>
<td>69.9</td>
</tr>
<tr>
<td>2000-01</td>
<td>621.6</td>
<td>572.4</td>
<td>(7.5)</td>
<td>21.8</td>
<td>92.1</td>
</tr>
<tr>
<td>2001-02</td>
<td>672.1</td>
<td>590.6</td>
<td>8.1</td>
<td>3.2</td>
<td>87.9</td>
</tr>
<tr>
<td>2002-03</td>
<td>788.0</td>
<td>812.7</td>
<td>17.2</td>
<td>37.6</td>
<td>103.1</td>
</tr>
<tr>
<td>Figures for the period</td>
<td>7929.2</td>
<td>5218.7</td>
<td>6.1</td>
<td>10.2</td>
<td>65.8</td>
</tr>
</tbody>
</table>

**N.B.** Figures in parentheses denote the negative value.
6.8 WORKING CAPITAL FINANCE IN TERMS OF MONTHS AVERAGE REVENUE TURNOVER.

6.8.1 The size of working capital finance is divided by month's average revenue turnover shows its adequacy/inadequacy. Table 6.4 shows the working capital finance of the Aluminium Industry of India in term of month's average revenue turnover for the period covered by this study. Table 6.4 shows that the size of working capital finance for the industry was less than 6 month's average revenue turnover. It has a fluctuating trend. It was highest (6.72 month's average revenue turnover) in 1997-98 and lowest (2.81 month's) in 2002-03. There is no rule of thumb for month's average revenue turnover. It is varied from industry to industry. Overall we can conclude, it was good sign for the industry that it was less than a year.

6.8.2 Table 6.5 presents the relative position of long and short-term debt in financing working capital. As we have seen, short-term funds have financed in an average 32.9 percent of working capital of the industry during the study period. Both the figures of short-term funds to working capital and long-term capital to long-term funds have a fluctuating trend. The percentages of short-term funds in financing working capital at the beginning of our study i.e. in 1991-92 was 36.1, whereas it rose to 47.5 at the end. It shows that the
### TABLE 6.4

WORKING CAPITAL FINANCE IN TERMS OF MONTH’S AVERAGE REVENUE TURNOVER OF ALUMINIUM INDUSTRY OF INDIA from 1991-92 to 2002-03

(Rs in crores)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>NET WORKING CAPITAL</th>
<th>MONTH’S AVERAGE REVENUE (SALES/12)</th>
<th>WORKING FINANCES IN TERMS OF MONTH’S AVERAGE REVENUE TURNOVER</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>1129.9</td>
<td>201.33</td>
<td>5.61</td>
</tr>
<tr>
<td>1992-93</td>
<td>1340.0</td>
<td>246.69</td>
<td>5.43</td>
</tr>
<tr>
<td>1993-94</td>
<td>1579.3</td>
<td>249.89</td>
<td>6.32</td>
</tr>
<tr>
<td>1994-95</td>
<td>1911.9</td>
<td>310.19</td>
<td>6.16</td>
</tr>
<tr>
<td>1995-96</td>
<td>2121.6</td>
<td>377.78</td>
<td>5.62</td>
</tr>
<tr>
<td>1996-97</td>
<td>2226.8</td>
<td>376.77</td>
<td>5.91</td>
</tr>
<tr>
<td>1997-98</td>
<td>27.93.5</td>
<td>415.69</td>
<td>6.72</td>
</tr>
<tr>
<td>1998-99</td>
<td>2660.1</td>
<td>417.02</td>
<td>6.38</td>
</tr>
<tr>
<td>1999-00</td>
<td>2175.0</td>
<td>501.24</td>
<td>4.34</td>
</tr>
<tr>
<td>2000-01</td>
<td>1693.5</td>
<td>553.82</td>
<td>3.06</td>
</tr>
<tr>
<td>2001-02</td>
<td>2038.7</td>
<td>547.58</td>
<td>3.72</td>
</tr>
<tr>
<td>2002-03</td>
<td>2282.1</td>
<td>812.97</td>
<td>2.81</td>
</tr>
<tr>
<td>Average</td>
<td></td>
<td></td>
<td>5.17</td>
</tr>
</tbody>
</table>
Industry is depending more and more on short-term funds for financing working capital. Similarly, long-term working capital funds to total long-term funds of the Industry was 21.6 percent in 1991-92, whereas it reduce to 14.1 percent in 2002-03. Thus we can conclude that the Aluminium Industry of India is gradually relying more on other sources of funds rather than long-term sources of working capital for financing its long-term activities/assets.

6.8.3 Under the normal conditions, a bulk of the working capital requires need to be financed through long-term funds. From the Table 6.1, we observed that an average of 66.1 percent of the total working capital is financed by the long-term funds. However, excessive dependence on long team sources for financing working capital depicts inefficient management of the current assets: namely; inventories and receivables or sundry debtors.

6.9 SUMMARY

6.9.1 A business firm has different sources to meet its financial requirements. To select a particular source, a finance manager has to consider the merits and demerits of same in the context of the constraints of the firm. On the basis of time, the sources of finance of a firm in an Industry is classified into two categories, viz. long-term and short-term sources. Moreover, each of the source is again classified into internal and external.
### TABLE 6.5
FINANCING OF WORKING CAPITAL
(Rs. In Crores)

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Gross Working Capital</td>
<td>1769.3</td>
<td>2071.1</td>
<td>2240.6</td>
<td>2784.8</td>
<td>2934.5</td>
<td>3193.4</td>
<td>3673.3</td>
<td>3617.7</td>
<td>3148.8</td>
<td>3136.2</td>
<td>3323.8</td>
<td>4343.5</td>
</tr>
<tr>
<td>a) Short-term funds</td>
<td>639.4</td>
<td>731.1</td>
<td>661.3</td>
<td>872.9</td>
<td>812.9</td>
<td>966.6</td>
<td>879.8</td>
<td>957.6</td>
<td>973.8</td>
<td>1442.7</td>
<td>3323.8</td>
<td>4343.5</td>
</tr>
<tr>
<td>b) Long-term funds</td>
<td>1129.9</td>
<td>1340.0</td>
<td>1579.3</td>
<td>1911.9</td>
<td>2121.6</td>
<td>2226.8</td>
<td>2793.5</td>
<td>2660.1</td>
<td>2175.0</td>
<td>1693.5</td>
<td>2038.7</td>
<td>2282.1</td>
</tr>
<tr>
<td>2. Total Long-term funds *</td>
<td>5226.8</td>
<td>6511.4</td>
<td>6762.4</td>
<td>7141.6</td>
<td>7592.8</td>
<td>7941.9</td>
<td>9255.2</td>
<td>10408.0</td>
<td>11276.3</td>
<td>12178.4</td>
<td>13775.4</td>
<td>16163.1</td>
</tr>
<tr>
<td>3. Short-term funds to working capital (in %)</td>
<td>36.1</td>
<td>35.3</td>
<td>29.5</td>
<td>31.4</td>
<td>27.7</td>
<td>30.3</td>
<td>23.9</td>
<td>26.4</td>
<td>30.9</td>
<td>46.0</td>
<td>38.7</td>
<td>47.5</td>
</tr>
<tr>
<td>4. Long-term working capital funds to total long-term funds {useful for financing working capital (in %)}</td>
<td>21.6</td>
<td>20.6</td>
<td>23.3</td>
<td>26.8</td>
<td>27.9</td>
<td>28.0</td>
<td>30.2</td>
<td>25.6</td>
<td>19.3</td>
<td>13.9</td>
<td>14.8</td>
<td>14.1</td>
</tr>
</tbody>
</table>

Average Percentage of:
1. Short-term funds to working capital – 32.9%
2. Long-term working capital funds to total long-term funds 21.4%
* Total long-term funds = Net worth + Long-term debts
6.9.2 The long-term internal sources include retained earnings and depreciation provisions; whereas equity capital, debentures and long-terms loans from financial institutions, cum under long-term extronal sources category. Similarly, provision for dividend and provision for taxation are included under short-term internal source and on the otherhand, trade credits, bank credits, public deposits, commercial papers, etc. comes under short-term external sources of finance.

6.9.3 The minimum amount of current assets, which is required to ensure the effective utilisation of fixed facility and per maintaing the circulation of fixed assets is called permanent working capital and the amount of working capital required to meet the seasonal demands and special exigencies is called "temporary working capital". The permanent working capital is financed by equity capital, debentures, public deposits, loans from financial institution and retained earnings, whereas temporary working capital is financed by cash credit, over draft, discounting bills and term-loans.

6.9.4 There are three basic approaches to determine an appropriate financing mix, such as, hedging or matching approach, conservative approach and aggressive approach. According to the "hedging approach", the permanent portion of working capital should be financed with the long-term funds and
seasonal portion with short-term funds. The conservative approach suggest that the short-term funds should be used only in the case of emergencies and in other cases long-term funds is advised. However, the aggressive demand that even some part of the permanents current assets may be financed by short-term funds.

6.9.5 For financing the working capital, the bank has also important role. To regulate and control the bank finance the Reserve Bank of India set up different committees from time to time. These committees recommend some policies and also give some suggestions. In 1968, Daheja committee was set up to examine the extent of credit needs by the industry. In 1974, Reserve Bank of India constituted a Study Group under the Chairmanship of Sri Prakash Tondon. It is constituted to suggest the invenory norms for different industries, capital structure of the industry and pattern of the financing working capital etc. In 1979, Reserve Bank of India appointed another committee under the Chairmanship of Sri K.B. Chore to review the system of credit. In 1982, Reserve Bank of India appointed a committee under the Chairmanship of Marathe to review the workings of Credit Authorisation Scheme and to suggest the credit management. And in 1985, Chakraborty Committee report was set up. This Committee recommends penal interest for delayed payment and classification of credit limits.
6.9.6 From the analysis of short-term financing, we observed that sundry creditors, bank loans and other current liabilities constituted about 14.4 percent, 7.3 percent and 12.2 percent of the total short-term finance respectively. We also observed that, the long-term loans and reserves and surpluses provide 66.1 percent for financing the gross working capital. Moreover, during the period of the study, we found that reserves and surpluses and long-term loans showed an increasing trend.

6.9.7 Trade credit has also an important role in the financing of working capital. For the period of our study, the volume of sundry debtors exceeds the volume of sundry creditors. But the annual growth rate of sundry creditors exceeds that of sundry debtors. On an average, the volume of sundry creditors was 59.8 percent of sundry debtors during the period of our study. From the table 6.4, we found that the working capital finance for the industry was less than 6 month's average turnover. Of course, it is a good sign for the industry, because it is less than a year. For financing the working capital, short-term funds constitute about 32.9 percent and the rest is financed by long-terms funds. Moreover, our study reveals that about 21.6 percent total long-term funds (i.e. networth and long-term debts) of the industry is utilise for financing working capital.
REFERENCES


☆☆☆