CHAPTER 1

INTRODUCTORY

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1.1 INTRODUCTION

1.1.1 Financial Management focuses not only on the procurement of funds, but also on their efficient use with the objective of maximising the owner's wealth. The allocation of funds is, therefore, an important function of financial management. The allocation of funds involves the commitment of funds to assets and activities. It also refers to the investment decision, i.e., making a choice regarding the assets in which funds will be invested. These assets fall into two broad categories: (i) short-term assets or current assets, and (ii) long-term assets or fixed assets. Accordingly, there are two types of investment decisions. The first one is the short-term investment decision and known as management of current assets or working capital management. The second type of decision is the long-term investment decision and is widely known as capital budgeting or capital expenditure decision.

1.1.2 Working capital management is one of the most important aspects of over-all financial management. Technically, working capital management is an integral part of the over-all financial management. To that extent, it is similar to the long-term decision-making process, because both entail an analysis of the effect of risk and profitability. The problems involved in the management of working capital differ from those in fixed assets. In the first place, fixed assets are acquired to be retained in the
business over a period and yield returns over the life of the assets. In contrast, the stock-in-trade of working capital management, by definition, is a short-term asset. These types of assets lose their identity quickly, usually within a year. In the management of working capital, therefore, the time factor is not crucial as a decision variable.

1.1.3 Another notable feature of short-term assets is the question of liquidity versus profitability and the related aspect of risk. If the size of such assets is large, the liquidity position would improve, but profitability would be adversely affected, as funds will remain idle. Conversely, if the holdings of such assets are relatively small, the over-all profitability will no doubt increase, but it will have an adverse effect on the liquidity position and make the firm more risky. Working capital management should, therefore, aim at striking a balance such that there is an optimum amount of short-term assets.

1.2 IMPORTANCE OF THE STUDY

1.2.1 A study of working capital is of major importance to internal and external analysts because of its close relationship with day-to-day operations of a business. "The inadequacy or mismanagement of working capital is one of the leading causes of business failure". 
1.2.2 The management of working capital is becoming increasingly important as firms realise that approximately half of their investments are in working capital.

1.2.3 "A firm must maintain a satisfactory level of working capital. Current assets should be large enough to cover current liabilities in order to ensure a reasonable margin of safety"².

1.2.4 "In view of multiplicity of factors exerting varied degrees of influence on working capital studies, a management has to be alert to internal and external environmental developments, constantly plan and review its working needs and strategy"³.

1.2.5 Working capital management involves all aspects of administration of current assets and current liabilities. In the words of S.C.Kuchhal, "Working Capital Management involves deciding upon the amount and composition of current assets and how to finance these assets". James.C.Van Horne observes, "Working capital management usually is considered to involve the administration of current assets, namely cash, marketable securities, receivables, inventories and administration of current liabilities"⁴.

1.2.6 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.
Hence, poor management and absence of management skills are the main causes of business failure. Therefore, working capital management is very necessary to have adequate, healthy and efficient circulation of working capital.

1.2.7 "The importance of working capital management is reflected in the fact that financial managers spend a great deal of time in managing working capital"5. Current assets have a large portion of the total investment in a firm. In some industries, current assets represent as an average over three-fourth of the total assets.

1.2.8 Unlike fixed assets, current assets reflect a company's daily activities. Usually, they are most active in the company. Working capital management is extremely important in small business, since it is relatively more important in small companies than in large companies. A firm may sometimes be able to reduce investment in fixed assets by renting or leasing plant and machinery, but it cannot avoid investment in current assets.

1.2.9 Working capital management has emerged as a major factor in the profitability of business. This has been caused in part by the high cost of funds and the complexities of the business environment. The goal of working capital management is to minimise the cost of working capital, while maximise a firm's profit. According to I.M. Pandey, "Management of working capital is of great help on
planning the repayment of long-term loans. However, liquidity of a firm depends upon the availability of cash to dispose off liabilities or bills at the time of their maturity”.

1.2.10 The Aluminum Industry is second only to the Steel Industry among the top ranking metal industries of India. The Indian Aluminium Industry started in 1938 with an initial production capacity of 2500 tonnes per annum. “Worldwide, there are some 3000 applications of aluminium. In India, it may be around 300”.

The extent of applications is inextricably link to the ease of availability and affordability in terms of purchasing power of the ultimate consuming sector. “The per capita consumption of aluminium in India is barely 500 gms. against 59 kgs. in the USA and 3.6 kgs. in Brazil”. In advance economies, aluminium is increasingly replacing wood and steel in the building sector and cans and containers are extensively used the world over and also aluminium is ideal packaging material for pharmaceutical processed goods.

1.2.11 Due to heavy demand of aluminium, there is a need of profitability and survival of this Industry. Efficient management of working capital is very necessary for smooth operations of a concern. Management accountants must pay adequate attention to the management of working capital and its components both on the assets as well as liabilities side. Inadequate attention to working capital, in effect, involves placing differential
values as different types of company funds. In this context, we propose to undertake a study in order to examine critically the "Working Capital Management in Aluminium Industry of India" and offer some suggestions to improve its working capital position.

1.3 OBJECTIVES OF THE STUDY

1.3.1 The study aims to:

1. Analyse the management of working capital in the Aluminium Industry of India in post liberalisation period.

2. Ascertain the amount of working capital and to assess its importance in total assets of Aluminium Industry.

3. Make an element-wise analysis of gross working capital to earmark the elements responsible for changes in working capital.

4. Make a trend analysis of sales and working capital to ascertain the pattern of growth and relationship existing between both the variables.

5. Find out the estimated working capital with the help of Simple Regression Model. The estimated working capital and actual working capital are compared with a view to ascertaining the shortage or excess, if any, and to examine the significance of such deviations.
Find out the working capital position of Aluminium Industry of India and the various policies in the business followed with respect to general operations, purchasing, financing, dividend and expansion etc.

Study about the optimal mix of short-term funds in relation to long-term capital in Aluminium Industry of India.

Study growth, strategy and prospects for the future development of the Industry.

1.4 SCOPE OF THE STUDY

1.4.1 The scope of working capital management is very wide and broad based. This study is concerned with the working capital management in Aluminium Industry of India. In the first part, we have reviewed the financial literatures pertaining to the working capital management. This part makes elaborate discussions on the concept of working capital needs, types, components, factors, theory of financing, etc. All these come under the purview of present study along with type of decisions involved in working capital management.

1.4.2 In the second part, we have made an analytical study of working capital management, by using different tools and techniques of Financial Management such as common-size-statement, ratio analysis, and funds flow analysis, cash flow analysis etc. and their interpretation.
1.5 THE PLAN OF THE STUDY

1.5.1 The study has been broadly divided into nine chapters. In Chapter One, we start with the introduction, which contains the importance, objectives and scope of the study. The Second Chapter sums up with methodology adopted in the study and hypothesis taken in it. The Third Chapter deals with the growth and development of Aluminium Industry of India. The Fourth Chapter of study deals with the review of theoretical literature of working capital, in which, meaning, importance, need, type, components, factors, determinants and decisions involved in working capital are discussed briefly and systematically. The Chapter Five deals with the dimensions of working capital management, tools and technique for managing inventory, cash, receivables and payables, working capital management under inflation and its significance, where as Chapter Six deals with the principles and sources of financing the working capital. The Seventh Chapter deals with the analysis and interpretations of the data for the Industry by using the different techniques such as funds flow analysis, ratio analysis, correlation analysis and common-size percentages etc. The Eighth Chapter of the study contains the element-wise analysis of the working capital through ratio analysis, trend analysis etc. Finally, the Chapter Nine constitutes the summary of the findings along with suggestions for improvement of the efficiency in the working capital management of Aluminium Industry of India.
REFERENCES


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