Chapter-III
CHAPTER-III

WORKING CAPITAL – CONCEPT AND COMPOSITION

(1) CONCEPT OF WORKING CAPITAL

Working capital is defined as the capital required for meeting the operational needs of a business enterprise. It is the instrument for utilising the capacity created by fixed capital. It has been named in different ways by different scholars. It was referred to as 'circulating capital' by C.W. Gersternberg and 'short-term funds' by Hastings. The most common nomenclature used for such capital is working capital.

The term 'working capital' refers to that part of total capital which is available and employed for carrying out the routine business operations of the enterprise. Thus the capital required for purchasing raw material, payment of direct and indirect expenses, carrying out production in stock and stores etc. is generally known as working capital. 'Working capital' is that capital with which the business is worked out.

As regards financial analysts and accountants they are of different views regarding the term 'working capital'. According to Harry G. Guthmann and Herbert G. Dougalt, "Working capital is the excess of current assets over current liabilities." Likewise R.D.
Kennedy and S.Y. Mc Mullen states “A working capital deficit exists if current liabilities exceed current assets.”

Current assets are those assets which will be converted into cash within the current accounting period or within the next year as a result of the ordinary operations of the business. They are cash or near cash resources. These include:

a) Cash and bank balances
b) Bills Receivables
c) Inventory:
   Raw materials, stores and spares, work in progress, finished goods
d) Prepaid expenses
e) Short – term advances
f) Temporary investments

The value represented by these assets circulates among several items. Cash is used to buy raw materials, to pay wages and to meet other manufacturing expenses.

Finished goods are produced. These are held as inventories. When these are sold, accounts receivables are created. The collection of accounts receivable brings cash into the firm. The cycle starts again.
Current liabilities are the debts of the organisations that have to be paid during the current accounting period or within a year. These include:

a) Creditors for goods purchased.
b) Outstanding expenses i.e. expenses due but not paid
c) Short term borrowings
d) Advances received against sales
e) Taxes and dividends payable
f) Other liabilities maturing within a year.

Working capital is also known as circulating capital, fluctuating capital and revolving capital.

There are two concepts of working capital – gross and net. Gross working capital is the total of all current assets, i.e. cash, marketable securities, accounts receivables, inventory and other current assets. Net working capital refers to the excess of current assets over current liabilities.

Both these concepts have their own uses and limitations. The gross concept is a going concern concept because for the productive utilisation of fixed assets, all current assets are necessary. Management is particularly interested in gross concept, as it is useful to assess the efficiency with which the current assets are utilised. The net concept is useful to judge the current financial soundness or the short – term liquidity of a concern and is of special interest to sundry creditors and suppliers of short – term loans and advances.
Gross concept emphasises the use and the net concept the source. Working capital in net concept is qualitative in character as it represents the equity and long-term financing portion of current assets, which is supposed to serve as a cushion of safety and security to current liabilities. The gross concept of working capital is quantitative in character because it represents the total amount of funds used for current operating purposes.

**Operating Cycle Concept Of Working Capital**

Both the concepts, gross and net of working capital, depend on year-end Balance Sheet for their contents. As Balance Sheet merely indicates the financial status as on the closing date of the organisation’s accounting year, these concepts do not represent the average or representative figure of working capital requirements for the year in question. The company’s operating phase can fall anywhere between the top of the highest peak and the bottom of the lowest trough in the activity cycle of the organisation. Therefore, operating cycle concept, which is based mainly on the organisation’s Profit and Loss Account including all operational inflows and outflows of values, cash and credit, and again based to a certain extent on the Balance Sheet of the organisation, has been gaining importance.

A comprehensive and coherent exposition of operating cycle concept was offered by Park and Gladson. According to them, “Operating cycle is the average time intervening between the acquisition of materials and services entering the production – distribution process and the final cash realisation.” Thus, the
operating cycle refers to the period that a business enterprise takes in converting cash back into cash. To illustrate, a manufacturing organisation uses cash to acquire inventory of materials that is converted into semi-finished goods and then into finished goods. When finished goods are disposed off to customers on credit, accounts receivables are generated. When cash is collected from customers, again cash is available for use in a fresh cycle of operations. At this stage one operating cycle is complete. As organisation allows credit to customers, it gets credit from suppliers called credit deferral period, which reduces operating cycle period. Resultant cycle is known as cash conversion cycle.

Operating cycle and cash conversion cycle can be illustrated from the following figure:

Operating Cycle Of An Organisation
This concept emphasises functional interpretation of the role of working capital. According to this concept, working capital is to support all operational activities of the organisation over a period of time and also to pay the current obligations for materials and expenses. If the organisation is to maintain liquidity and function properly, it has to invest funds in various short-term assets (working capital) during this cycle. It has to maintain cash balance to pay the bills as they become due.

The company must invest in inventories. The company invests in accounts receivables to extend credit to its customers.

Thus, the length of operating cycle, in a manufacturing concern, is the total of the following periods:

(i) Materials in storage period, say, ‘r’, represents the average time of materials that remain in store prior to the date of issue for production purposes.

(ii) Processing period, say, ‘w’, shows the time that may be taken on an average to convert raw materials into finished goods. It depends on the state of technological efficiency and supervisory ability of the firm.

(iii) Finished goods in storage period, say, ‘f’, represents the time for which finished goods, after completion of production, remain in warehouse before they are dispatched to customers.
(iv) Debtors’ collection period, say, ‘d’, represents the time lapse between sale of goods on credit resulting in debtors and their conversion into cash.

(v) Creditors’ deferral period, say, ‘c’, shows the time period the firm is able to defer payment on its various resource purchases. It will reduce the length of the operating cycle of the firm.

Thus,

Length of operating cycle = \( r + w + f + d \)

Length of cash conversion cycle = \( r + w + f + (d - c) \)

Number of cycles in a period

\[
= \frac{\text{Number of days in the relevant period}}{\text{Length of cycle}}
\]

The computations may be made as under:

\[
r = \frac{\text{Average inventory of raw materials and stores}}{\text{Average consumption of raw materials and stores per day}}
\]

\[
w = \frac{\text{Average inventory of work – in – progress}}{\text{Average cost of production per day}}
\]

\[
f = \frac{\text{Average inventory of finished goods}}{\text{Average cost of sales per day}}
\]

\[
d = \frac{\text{Average trade debtors}}{\text{Average credit sales per day}}
\]
c = \frac{\text{Average trade creditors}}{\text{Average credit purchases per day}}

The average inventory, trade creditors and trade debtors can be computed by dividing, the total of opening and closing balances in respective account of a particular period by two. The average per day figure can be calculated by dividing the concerned annual figures by 360 or number of days in the given period.

The operating cycle concept emphasises functional interpretation of the role of working capital. According to this concept, working capital is to support all operational activities of the organisation over a period of time and also to pay the current obligations for materials and expenses. Ability to pay current liabilities, as and when these fall due, is only a part of this wider function. This concept facilitates control of working capital. The operating cycle of past few years could be studied to determine the improvement in operating cycle period of the relevant year. Operating cycle concept helps exerting greater control on storage (raw materials including stores and finished goods), conversion process, debt liquidation and collection policies of a organisation. In other words, management can go deeper into each phase of operating cycle to look for possible economies in any or all of these phases. For creditors, attempts may also be made to prolong the repayment period, of course, without jeopardising goodwill, with a view to reduce the operating cycle period further.

Since, the main purpose of the present study is to analyse the size and structure of current assets, efficiency with which current
assets are utilised, pattern of financing of current assets and adequacy of working capital, both gross and net concepts of working capital have been used. Gross working capital concept is used to examine the issues relating to size, structure, efficiency, adequacy and financing of working capital. Net working capital concept is used while examining the financing of working capital by long-term sources and adequacy of working capital to pay off current liabilities. Operating cycle concept has been used for examining the efficiency with which investment in working capital is utilised.

(2) COMPOSITION OF WORKING CAPITAL

Present study is related with the problems of working capital management, it is therefore, desirable to study the composition of working capital having main features of current assets and current liabilities, in a scientific manner. Generally, two types of assets are purchased in the ordinary course of business: (1) Fixed assets which are used for long-period in the business, (2) Current assets which are kept for the selling purpose. The nature of the current assets used to be such that during relative period it tends to be converted in cash. At every moment of the trade cycle the frequency of current asset changes. Like assets, liabilities are also classified into two categories: (1) Long term liabilities (2) Current liabilities. Long term liabilities include such debentures and loans which are repaid after one year or more than one year. However current liabilities include such loans and liabilities which are repaid in less than one year.
The basis of classification of assets and liabilities into current and fixed is one year’s period. According to American Institute of Certified Public Accountants, “Current assets and current liabilities should be analysed on the basis of one year period. On this basis development used to have relationship with trade cycle.”

Obtaining raw material by production process and production sale and the services and the average period of conversion of them into cash is called time cycle. The American Institute of Certified Public Accountants has recognised one year as the basis for the analysis of current and fixed assets and liabilities. (a) When there used to be many operating cycles of one year (b) when operating cycles used to be of more than 12 months. The committee recommended long term operating cycles however in practice one year’s basis is more acceptable because in most of the working operating cycles used to be of less than one year.

Current assets and current liabilities are accepted in India in their meaning of usage. This is evident from the records of Reserve Bank of India and office directory of Mumbai Stock Exchange. As per Reserve Bank of India current assets include stock, loans and advances, balance of debtor account, securities other than shares in subsidiary companies, advance payment of income tax, cash and bank balance. Current liabilities include provision for income tax, loan from banks (except loans, debentures and mortgage of statutory corporations) trade liability and other current liabilities are included. According to the explanatory note of stock exchange office directory “There is a relative distinction between current and fixed assets.
Current assets represent cash and other those assets which are likely to be converted into cash or which may be consumed in sales. Marketable securities include items which may be converted into cash having cash at the top. Advance payment of tax, debtors and stock are also mentioned in this priority sequence. Thus liabilities of less than one year are included in it."

As per statements and records of HPCL following are assets and liabilities:

1) Current Assets:

(i) Cash in Hand and at Bank: Cash, bank, draft, current account in banks, savings account, cash in transit amount deposited in them and amount deposited in the post-office savings account. This includes amount deposited as per court order pending final disposal and security deposit with Mumbai Port Trust.

(ii) Sundry Debtors: Sundry debtors of goods. This includes all type of sundry debtors i.e. considered good as well as doubtful.

(iii) Stock: Store, spare parts, loose tools, goods in transit, stock of finished goods, work-in-progress, raw material, empty containers.

(iv) Loans and Advances: Advance income tax which is to be refunded, central excise duty, advance account, security bailment, prepaid expenses, sales bailment, accrued interest on
investment, purchase tax in advance, balances with excise, customs, Port Trust, amount recoverable under subsidy schemes, advance towards equity etc.

(v) Other : Suspense account, amount recoverable from contractors, claims of gratuity against government, interest accrued on bank deposits and investments.

2) Current Liabilities:

In HPCL current liabilities are divided in two parts:

(a) Current Liabilities:

(i) Creditors for fixed assets
(ii) Sundry creditors
(iii) Advance from customers
(iv) Retention money
(v) Earnest money of whole – seller
(vi) Dividend declared
(vii) Bank overdraft
(viii) Outstanding expenses
(ix) Other expenses:

- Accrued charges / credits
- Interest accrued but not due on loans
(b) Provisions:

(i) Provision for tax.
(ii) Provision for dividend.
(iii) Provision for pension
(iv) Provision for other retirement benefits
(v) Provision for fringe benefit tax
(vi) Tax on distributed profits.

(3) DETERMINANT FACTORS OF WORKING CAPITAL REQUIREMENT

The total working capital requirement is determined by a wide variety of factors. These factors differ from enterprise to enterprise and from time to time. However no rigid division is possible but still these factors may be classified as under:

(i) Common factors
(ii) Specific factors for Hindustan Petroleum Corporation Limited.

(i) COMMON FACTORS

Common factors are those factors which apply on all type of business enterprises whether they are classified as public enterprise or private enterprises. Common factors may further be classified as under:

a) Nature of business.

b) Production cycle.
c) Business cycle.
d) Production policy.
e) Credit policy.
f) Growth and expansion policy.
g) Regular supply of raw material.
h) Profit levels.
i) Level of taxes.
j) Dividend policy.
k) Depreciation policy.
l) Price level changes and
m) Operating efficiency.
a) Nature of business: The nature effects the requirement of working capital. The two basic considerations in this regard are:

1) The cash nature of business i.e. cash sale and
2) Sale of services rather than commodity.

Due to these features they do not keep big inventories and hence require least amount of working capital. On the other hand, there are trading and financial enterprises and there nature of business is such that they have to maintain sufficient amount of cash, inventories and book debts and necessity to invest proportionately large amounts in working capital. In case of industrial concerns fairly large
amount of working capital is required however definite requirement depends on their asset structure. The proportion of the current assets to total assets measures the relative requirements of working capital of various industries. Since this proportion differs from industry to industry it is very difficult to spell out exact requirement of every industry.

b) **Production cycle**: Production cycle is also known as manufacturing cycle and refers to the time involved in manufacturing. It covers the period between procurement of raw material and production of finished goods. The more is the gap between these two processes the more will be working capital requirements. To sustain such activities the need of working capital is obvious. There are enterprises which have shorter operating cycle due to their nature of business still the requirement of working capital depends how fast their products are converted into cash for e.g. a distillery which has an ageing process requires heavy investment in inventory. In case of bakery, since product of bakeries are sold fast and at shorter intervals and have a very high inventory turnover, needs lesser working capital. Even in the same group of industries the operating cycle may be different due to technological considerations. Introduction of advanced technologies reduce the operating cost and subsequently requirement of working capital.
c) **Business cycle**: Business cycle determines the capital requirement of a concern. Fluctuations in business may lead to cyclical and seasonal changes which in turn causes a shift in the working capital position particularly for temporary working capital requirements. There may be variations in upward i.e. boom conditions and down swing phase indicating decline in the business. When it is a boom period more working capital is required to cater the need of increased requirements similarly more capital will be required to meet out expansion activity and extra – installation of plant and machinery. In a declining market the need for working capital will also go down as there will be falling sales, production and book debts.

d) **Production policy**: Production policy also decides the quantum of working capital. In case of seasonal products the enterprises dealing in such products have two options : - (i) to restrict the production to the demand as and when it comes. (ii) to carry out the production throughout the year keeping in mind the requirement at the peak season. In the second case a huge quantity of working capital is required as the various production factors are to be maintained throughout the year while in the first case though the working capital requirement shall be lesser but there may be a supply gap. Both the systems have some problems in their implementation the best course therefore will be to adopt working capital planning in relation to sales and production.
e) Credit policy: Credit policy affects the requirement of working capital through period of credit purchases and the period of credit sales. If the period of credit sales is more this will increase the book debts similarly a liberal term available from suppliers will reduce the burden of working capital. The magnitude of credit determines the size of working capital. If the buyer is granted more credit period as compared to sellers then there will be a big need for working capital. However in the reverse situations the need for working capital shall be small. If in the finance market finance is dearer then credit period will be lesser and the working capital requirement may be greater. However a part of it will remain unused. Similarly in a cheaper finance market the working capital requirement shall be lesser as traders will always be confident to procure finance for working capital as and when it is required.

Competitiveness in the market also effect need of working capital. In a highly competitive market the working capital requirement may be more as longer credit periods will have to be allowed. Similarly in monopoly or near monopoly the working capital requirement can be lesser as span of credit may be fixed by the seller and not the buyer.

f) Growth and expansion policy: As and when an expansion programme of production and sales is implemented by the organisation concerned the need for working capital increases however if any squeeze programme is to be implemented the situation may reverse and the working capital requirement
shall be restricted. It is therefore necessary that a working capital planning may be adopted so that future needs may be accessed and provided for.

**g) Regular supply of raw material:** Availability of continuous raw material affects the requirement of working capital. If the material is regularly available then work can be carried out with small purchases of raw material involving lesser working capital because it will rotate very fast. If there is scarcity or irregular supply of raw material then manufacture will have to store the raw materials. Therefore more working capital will be required. The time period in procuring the raw material is very important. If more longer period is required then more working capital will be needed similarly if the supply is available in the short period then lesser working capital will be required.

**h) Profit levels:** Level of profit differ from enterprise to enterprise. In general the nature of the product hold on the market, quality of management and monopoly power would by and large determine the profit of the business. It can be generalised that a firm dealing in a high quality product, having a good marketing arrangement and enjoying monopoly powers in the market is likely to earn high profit and vice versa. Higher profit margins improve the prospects of generating more internal funds there by contributing to the working capital pool. However net profit is a source of working capital to the extent that it has been earned in cash.
Cash profits can be found out by adjusting non-cash items such as depreciation, outstanding expenses and losses written off in the net profit. But in practice the net cash inflows from operation cannot be considered as cash available for use at the end of the cash cycle. Even as the company’s operations are in progress cash is used for augmenting stock, book debts and fixed assets. It must therefore be seen that cash generation has been used for furthering the interest of the enterprise. It is in this context that elaborate planning and projections of expective activities and the resulting cash inflows on a day to day, week to week and month to month basis, assume importance because steps can then be taken to deal with surplus and deficit cash. Appropriation of profit for taxation, dividend, reserves and depreciation etc. decides the availability of funds.

i) **Level of taxes**: Tax liability is short - term liability payable in cash. An adequate provision for tax payments is therefore an important aspect of working capital planning. An increased tax liability will need an increase in the requirement of working capital and vice - versa. Management has no discretion in regard to the payment of taxes and in some cases non - payment may invite panel action. There is however wide scope to reduce the tax liability through tax planning. In tax planning various loop - holes are used in the favour of tax planner. Saving in tax through tax planning is called tax - avoidance and is not punishable however tax - evasion is
punishable. Infact tax – planning is the integral part of working capital planning.

j) **Divided policy**: The payment of dividend consumes cash resources and thereby affects working capital to that extent. It means non – payment of dividend and retaining of profits will increase working capital. In planning working capital requirement it is to be planned out whether whole of the profit is to be payed as dividend or a part of it will be payed to shareholders and the balance will be retained. When profits are huge it is easy to satisfy both the will of the directors and the shareholders but whenever the profit is comparatively small it is not possible to satisfy both and a decision has to be taken. How much dividend may be declared and payed is dependent on certain over relevant factors.

Much will depend on the nature and need of working capital. If there is aacute need of working capital then cash payment of dividend can be skipped otherwise vice – versa and bonus shares may be issued which is the easiest way of paying dividend without draining away cash.

k) **Depreciation policy**: Depreciation policy used to have an ‘impact on the quantity of working capital. Depreciation charges do not involve any drainage of cash from business. Depreciation policy does not have direct impact on working capital. In the first place, depreciation affects the tax liability and retention of profits. Depreciation is allowable expenditure in calculating net profits. Increased rates of depreciation
reduces profit and subsequently reduces tax liability also. Reduction in tax liability increases retention of cash in business as lesser tax payments will mean lesser cash outflow. Reduction in size of profit due to enhanced depreciation will also reduce the size of payment of dividend thus cash will be preserved.

At second place, the selection of the method of depreciation has important financial implications. If current capital expenditure falls short of the depreciation provision, the working capital position is strengthened and there may be no need for borrowings. If, on the other hand, the current capital expenditure exceeds the depreciation provision, either outside borrowing will have to be resorted to or a restriction on dividend payment coupled with retention of profits will have to be adopted to prevent the working capital position from being adversely affected. It is in these ways that depreciation policy is relevant to the planning of working capital in a firm.

1) **Price level changes**: Changes in the price level also affect the requirements of working capital. Rising prices would necessitate the use of more funds for maintaining an existing level of activity. For the same level of current assets, higher cash outlays will be required. The effect of rising prices will be that a higher amount of working capital will be needed. In the case of companies, however, which can raise their prices proportionately, there will be no serious problem regarding
working capital. Moreover, the price rise does not have a uniform effect on all commodities. It is likely that some firms may not be affected at all. In brief, the implications of changing price levels on working capital position will vary from company to company depending on the nature of its operations, its standing in the market and other relevant considerations.

m) Operating efficiency: The working capital level is also determined by efficiency of management. Management can contribute to a sound working capital position through operating efficiency. Although management cannot control price rise, it can ensure the efficient utilisation of resources by eliminating waste, improving co-ordination and a fuller utilisation of existing resources etc. Efficiency of operations exhilarates the pace of the cash cycle and improves the working capital turnover. It releases the pressure on working capital by improving profitability and improving the internal generation of funds.

(ii) SPECIFIC FACTORS FOR HINDUSTAN PETROLEUM CORPORATION LIMITED

For studying the determinant factors of working capital requirement of Hindustan Petroleum Corporation Limited the percentage of current assets with total assets is calculated. This percentage is shown in the table no. 3.1 :-
Table No. 3.1
Percentage of current assets with total assets

<table>
<thead>
<tr>
<th>Years</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>58.91</td>
</tr>
<tr>
<td>2004-05</td>
<td>57.78</td>
</tr>
<tr>
<td>2005-06</td>
<td>60.01</td>
</tr>
<tr>
<td>2006-07</td>
<td>56.52</td>
</tr>
<tr>
<td>2007-08</td>
<td>61.80</td>
</tr>
<tr>
<td>2008-09</td>
<td>57.85</td>
</tr>
<tr>
<td>2009-10</td>
<td>57.42</td>
</tr>
<tr>
<td>Invested percentage</td>
<td>58.61</td>
</tr>
</tbody>
</table>

Source: Compiled from various Annual Reports of HPCL

This is clear from the table no. 3.1 that invested percentage of current assets with total assets is 58.61 which is higher than standard percentage 50. From this it may be concluded that the proportion of invested total net assets is higher and the management has invested more than 50% of the funds in the current assets. This indicates that sufficient working capital is with the company.

(4) SOURCES OF WORKING CAPITAL:

(i) GENERAL STUDY OF RESOURCES

Working capital can be financed with two types of sources of funds which are:
1) Sources of permanent working capital or long — term sources of funds and

2) Sources of temporary working capital or short — term sources of funds

1) SOURCES OF PERMANENT WORKING CAPITAL OR LONG — TERM SOURCES OF FUNDS

Permanent working capital is the amount of funds required to produce the goods and services necessary to satisfy demand at its lowest point. This type of working capital is as permanent investment in fixed assets. This is so because there is always a minimum level of current assets which is continuously required by the enterprise to carry out its day to day business operations and this minimum can not be expected to reduce at any time. The minimum level of current assets gives rise to permanent or fixed working capital as this part of working capital is permanently blocked in current assets.

Sources of permanent working capital are:

i) Shares
ii) Debentures
iii) Public Deposits
iv) Loan from financial institutions
v) Ploughing back of profits

i) Shares: Issue of shares is the most important source for raising the permanent or long - term capital. A company can issue two type of shares as equity shares and preference shares.
Preference shares carry preferential right in respect of dividend at a fixed rate and in regard to the repayment of capital at the time of winding up of the company. Equity shares do not have any fixed commitment charge and the dividend on these shares is to be paid subject to the availability of sufficient profits. As far as possible, a company should raise the maximum amount of permanent capital by the issue of shares.

ii) **Debentures**: A debenture is an instrument issued by the company acknowledging the debt to its holder. It is also an important method of raising long term or permanent working capital. The debenture – holders are the creditors of the company. A fixed rate of interest is paid on debentures. The interest on debentures is a charge against Profit and Loss Account. The debenture as source of finance have a number of advantages both to the investors and to the company, since interest of debentures have to be paid on certain determined intervals at a fixed rate and also debenture get priority on repayment at the time of liquidation. They are very well suited to continuous investors. The firm issuing debenture also enjoy a number of benefits such as trading on equity, retention of control, tax benefits etc.

iii) **Public Deposits**: Public deposits are the fixed deposits accepted by a business enterprise directly from the public. This source of raising short – term and medium term was very popular in the absence of banking facilities.
iv) **Loan from financial institutions**: Financial institutions such as commercial banks, LIC, ICICI, Industrial Finance Corporation of India, State Financial Corporation, State Industrial Development Corporation Bank of India, etc. also provide short-term, medium-term, and long-term loans. Interest is charged on such loans at a fixed rate and the amount of the loan is to be repaid by the way of instalments in a number of years.

v) **Ploughing back of profits**: Means the reinvestment by a concern of its surplus earnings in its business. It is an internal source of finance and is most suitable for an established firm for its expansion, modernisation and replacement, etc. This method of finance has a number of advantages as it is the cheapest rather cost-free source of finance; there is no need to keep securities; there is no dilution of control; it ensures stable dividend policy and gains confidence of the public. But excessive resort to ploughing back of profits may lead to monopolies, misuse of funds, over-capitalisation and speculation, etc.

2) **SOURCES OF TEMPORARY WORKING CAPITAL OR SHORT-TERM SOURCES OF FUNDS**

Temporary working capital changes its form from cash to inventory to receivable and back to cash but it differs in that it is not always gainfully employed. Businesses that are seasonal and/or cyclical in nature require more temporary working capital than firms that are not so influenced. Therefore, managers should obtain the
capital that is temporarily invested in current assets from sources that will allow its return when not in use. If this policy is followed, the turnover of investment will be more favourable thus permitting a more efficient use of capital. The temporary working capital requirements are met from the short-term sources of capital.

Working capital required for limited period of time may be secured from following temporary sources:

i) Trade creditors
ii) Depreciation as a source of working capital
iii) Commercial Banks
iv) Indigenous Bankers
v) Tax Liabilities
vi) Account Receivable

i) Trade creditors: As present day commerce is built upon credit, the trade credit arrangement of a concern with its suppliers is an important source of short term finance. The main advantages of this source are:

a) It is very convenient method of finance.
b) It is flexible and it may be possible to obtain favourable term.

However, the biggest disadvantage of this method of finance is charging of higher prices and loss of cash discount.

ii) Depreciation as a source of working capital: Increase in working capital results from the difference in the amount of
depreciation allowance deducted from earnings and new investment made in fixed assets.

Usually, the entire amount deducted towards depreciation on fixed assets is not invested in the acquisition of fixed assets and is saved and utilised in business as working capital. This is also a temporary source of working capital as long as the acquisition of fixed asset is deferred.

iii) **Commercial Banks**: Commercial banks are the most important source of short-term capital. The major portion of working capital loans are provided by commercial banks. They provide a wide variety tailored to meet the specific requirement of a concern. The different forms in which the banks normally provide loans and advances are:

a) Loans
b) Cash Credits
c) Overdrafts
d) Purchasing and Discounting of Bills

iv) **Indigenous Bankers**: Private money lenders and other country bankers used to be the only source of finance prior to the establishment of commercial banks. They used to charge a very high rate of interest and exploited the customers to the largest extent possible.

v) **Tax Liabilities**: Deferred payment of taxes is also a source of working capital. Taxes are not paid from day to day, but estimated liability for taxes is indicated in balance sheet.
Besides, business organisations collect taxes by way of income tax payable on salaries of staff deducted at source, old age retirement benefits, excise taxes, sales taxes, etc. and retain them for some period in business to be used as working capital.

vi) Account Receivable: The term receivables is defined as debt owed to the firm by customers arising from sale of goods or services in the ordinary course of business. When a firm makes an ordinary sale of good or services and does not receive payment, it grants trade credit and create accounts receivable which would be collected in the future. These represent the extension of credit on an open account by the firm to its customers.

(ii) STUDY OF RESOURCES IN CONTEXT OF HINDUSTAN PETROLEUM CORPORATION LIMITED:

Table no. 3.2 explains the sources of working capital and its utilisation in Hindustan Petroleum Corporation Limited:

<table>
<thead>
<tr>
<th>Table No. 3.2</th>
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<tbody>
<tr>
<td>Analysis of sources for procurement of working capital and its utilisation</td>
</tr>
<tr>
<td>(Rs. in crores)</td>
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<table>
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</thead>
<tbody>
<tr>
<td>Sources of funds:</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit after tax</td>
<td>1903.94</td>
<td>1277.33</td>
<td>405.63</td>
<td>1571.17</td>
<td>1134.88</td>
<td>574.98</td>
<td>1301.37</td>
</tr>
<tr>
<td>Depreciation</td>
<td>606.58</td>
<td>659.59</td>
<td>690.23</td>
<td>704.00</td>
<td>856.41</td>
<td>981.29</td>
<td>1164.40</td>
</tr>
<tr>
<td></td>
<td>172.12</td>
<td>175.92</td>
<td>124.57</td>
<td>152.55</td>
<td>189.59</td>
<td>193.98</td>
<td>515.68</td>
</tr>
<tr>
<td>--------------------------------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
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</tr>
<tr>
<td>LPG Deposits</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowings (Net)</td>
<td>382.32</td>
<td>307.37</td>
<td>4322.23</td>
<td>3784.38</td>
<td>6301.17</td>
<td>6173.46</td>
<td>(1270.19)</td>
</tr>
<tr>
<td>Share Capital</td>
<td>0.07</td>
<td>0.03</td>
<td>0.01</td>
<td>0.01</td>
<td>0.07</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Share Premium</td>
<td>2.41</td>
<td>0.83</td>
<td>0.39</td>
<td>0.47</td>
<td>2.05</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Redemption of Oil Bonds</td>
<td>-</td>
<td>300.00</td>
<td>850.00</td>
<td>1950.73</td>
<td>4535.00</td>
<td>9039.47</td>
<td>5270.27</td>
</tr>
<tr>
<td>Receipt of capital Grants from OIDB</td>
<td>-</td>
<td>-</td>
<td>4.94</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Amortisation of capital Grants</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(0.19)</td>
<td>(0.20)</td>
<td>(0.19)</td>
<td>(0.19)</td>
</tr>
<tr>
<td>Charge against General Reserve on account of Transitional Liability of AS – 15R</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(53.31)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Oil Bonds receivable</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3448.45</td>
<td>2033.99</td>
<td>-</td>
</tr>
<tr>
<td>Redemption/Sale of Investment</td>
<td>0.21</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Provision for Deferred Tax</td>
<td>54.04</td>
<td>(79.33)</td>
<td>9.69</td>
<td>36.46</td>
<td>202.53</td>
<td>7.39</td>
<td>204.60</td>
</tr>
<tr>
<td>Deferred Tax Asset due to AS – 15R implication</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(27.45)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Adj on account of sale / deletion of Assets and Provision for diminution in investment</td>
<td>43.37</td>
<td>6.81</td>
<td>1.66</td>
<td>99.30</td>
<td>62.42</td>
<td>(75.28)</td>
<td>703.73</td>
</tr>
<tr>
<td>Total</td>
<td>3165.06</td>
<td>2648.55</td>
<td>6409.35</td>
<td>8298.88</td>
<td>16651.61</td>
<td>18929.09</td>
<td>7889.67</td>
</tr>
<tr>
<td>Utilisation of funds</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>----------------------</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Dividend</td>
<td>746.81</td>
<td>509.00</td>
<td>101.80</td>
<td>610.80</td>
<td>101.59</td>
<td>177.78</td>
<td>406.35</td>
</tr>
<tr>
<td>Tax on Distributed profits</td>
<td>95.65</td>
<td>71.15</td>
<td>14.28</td>
<td>97.75</td>
<td>17.26</td>
<td>30.21</td>
<td>67.49</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>941.32</td>
<td>1322.63</td>
<td>2694.43</td>
<td>4096.30</td>
<td>3066.91</td>
<td>2372.80</td>
<td>3712.68</td>
</tr>
<tr>
<td>Working capital : Increase / (Decrease)</td>
<td>1347.07</td>
<td>738.63</td>
<td>456.75</td>
<td>(1607.02)</td>
<td>5497.36</td>
<td>(1999.74)</td>
<td>141.74</td>
</tr>
<tr>
<td>Investment – JVCs (Incl. Advance towards Equity and share application money pending allotment)</td>
<td>34.21</td>
<td>7.12</td>
<td>21.29</td>
<td>171.16</td>
<td>265.49</td>
<td>206.82</td>
<td>1527.41</td>
</tr>
<tr>
<td>Investment in Oil Bonds</td>
<td>-</td>
<td>-</td>
<td>3120.80</td>
<td>4929.89</td>
<td>7703.00</td>
<td>18141.22</td>
<td>2033.99</td>
</tr>
<tr>
<td>Total</td>
<td>3165.06</td>
<td>2648.55</td>
<td>6409.35</td>
<td>8298.88</td>
<td>16651.61</td>
<td>18929.09</td>
<td>7889.67</td>
</tr>
</tbody>
</table>

Source: - Compiled from various Annual Reports of HPCL

On the analysis of table no. 3.2 it is found that net borrowings and redemption of oil bonds have been the main sources of funds during this period. Profit also contributed a lot in this regard. In the year 2003 – 04 the profit after tax was Rs. 1903.94 crores while it was Rs. 1301.37 crores in the year 2009 – 10. The redemption of oil bonds was nil in the year 2003 – 04 but in the year 2004 – 05 it was Rs. 300 crores and reached upto the level of Rs. 5270.27 crores in

On the utilisation side company has paid dividend every year and the capital expenditure in the year 2003 – 04 was recorded Rs. 941.32 crores. This figure went up every year and was highest in the year 2006 – 07 at Rs. 4096.30 crores. However in its subsequent year of 2007 – 08 and 2008-09 this figure came down to Rs. 3066.91 crores and Rs. 2372.80 crores respectively. However in the year 2009-10 the figure increased to Rs. 3712.68 crores in comparison to its past two years but is still less than the figure of 2006-07. Every year there was increase in working capital except for the years 2006 – 07 and 2008-09 when there was a decrease of Rs. 1607.02 crores and Rs. 1999.74 crores respectively. The investment in oil bonds have been started since 2005 – 06 and this figure is increasing every year and has increased more than five folds in the year 2008-09 but in the year 2009-10 the investment in oil bonds was reduced to Rs. 2033.99 crores.

(5) LIQUIDITY, PROFITABILITY AND WORKING CAPITAL OF HIUNDUSTAN PETROLEUM CORPORATION LIMITED

In the long term activities of the trading concern working capital is accepted as a connecting factor because it directly influences the financial condition of the concern. Risk and liquidity – both factors are the main ascertaining factors of the profitability that directly effects the value of money. There are two dimensions of the value of money – first: time spent on converting assets into
money, second: certainty of receiving and realisation of prices. In liquidity quantum of current liquid assets, their structure, cyclic flow of an asset and technical solvency are included to measure the limit of current liquid assets at short-term basis. Current assets are generally known as liquid assets because they are regularly converted into cash. At the time when all the other things remain the same and the relative ratio of liquid assets is high risk related to cash remains less as a result of this profitability reduces. Contrary to it when the relative ratio of liquid assets is less the ratio of profitability remains high but the quantum of risk increases. Above decisions between profitability and risk are effected by slow business condition.