Chapter 5
CHAPTER-5

Working Capital Finance

Meaning:

The source from which the funds will be raised to meet the working capital requirement has to be planned. Once the level of working capital has been determined, in any company, a part of capital is blocked to maintain minimum level of current assets is known as Fixed working capital. The investment in Raw Material, Stock in process, Finished goods and Receivables often varies a great deal during the course of the year. Hence the source has to been maintained for financing money for above activity.

Variance in working capital may be due to Seasonal demands, Rise in price of resources, Strikes, etc. The fixed proportion of working capital should generally be financed from the fixed capital sources, while temporary requirement of a firm may be meet from short term source of capital.

5.1 Determination:

Determination of working capital depends upon -

1. The size of firm investment in current assets: It is measured with total operating revenue. A flexible short term policy would maintain high ratio of current assets to sales.

2. The financing of current assets: It is measured on financed current assets over current liabilities. A restrictive short term financial policy means a high portion of short term debt & flexible policy means less short term debt. A flexible policy results in effect of high level of net working capital.

However some other points are also considered, they are:

1. Making large investment in Inventory.

2. Keeping large cash balance.
A good finance manager's job is to determine the optimal level of investment in short term requirement on identification of the different costs of alternating short term financing policy.

Current assets holding are highest with a flexible short term financial policy lowest with a restrictive policy. So, flexible short term financial policies are costly in that they require a greater investment in cash and marketable securities, inventory, and accounts receivable. However, we expect that future cash inflows will be higher with a flexible policy.

A more restrictive short-term financial policy probably reduces future sales to levels below those that would be achieved under flexible policies. It is also possible that higher prices can be charged to customers under flexible working capital policies. Customers may be willing to pay higher prices for the quick delivery service and more liberal credit terms implicit in flexible policies.

Managing current assets can be thought of as involving a trade-off between costs that rise costs that fall with the level of investment. Costs that rise with increases in the level of investment in current assets are called carrying costs. The larger the investment a firm makes in his current assets, the higher its carrying costs will be. Costs that fall with increases in the level of investment in current assets are called shortage costs.

Shortage costs are incurred when the investments in current assets is low. If a firm runs out of cash, it will be forced to sell marketable securities. Of course, if a firm runs out of cash and cannot readily sell marketable securities, it may have to borrow or default on an obligation. This situation is called a cash-out. A firm may lose customers if it runs out of inventory (a stock-out) or if it cannot extend credit to customers.

A top part of figure given below illustrates the basic trade-off between carrying costs and shortage costs. On the vertical axis, we have costs measured in Rs. and, on the horizontal axis, we have the amount of current assets.
Short-term Financial Policy: The Optimal Investment in Current Assets

Carrying costs increase with the level of investment in current assets. They include the cost of maintaining economic value and opportunity costs. Shortage costs decrease with increases in the level of investment in current assets. They include trading costs and the costs related to being short of the current assets (for example, being short of cash). The firm's policy can be characterized as flexible or restrictive.

A. Flexible policy

A flexible policy is most appropriate when carrying costs are low relative to shortage costs.
B. Restrictive policy

A restrictive policy is most appropriate when carrying costs are high relative to shortage costs.

5.1.1 Best Financing Policy:

1. **Cash Reserve**: The flexible financing policy implies surplus cash and little short term borrowing. The policy reduces the probability that a firm will experience financial distress.

2. **Maturity Ledging**: Firm likely to match maturities of assets & liabilities. Firm avoids financing lived assets with short term borrowings.

3. **Relative Interest Rates**: Short term interest rates are usually lower than long term rates.
5.2 Source of Working Capital Finance:

There are various sources of financing working capital. Company may choose any one as per their requirement.

### Sources

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<th>Short Term Needs</th>
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<td>3. Public Deposite</td>
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<tr>
<td>5. Loan From Financial Institutions</td>
<td>5. Advance</td>
</tr>
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<td></td>
<td>6. Factoring</td>
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<td>7. Accrued Expenses</td>
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<td></td>
<td>8. Commercial Papers</td>
</tr>
</tbody>
</table>

Fixed or Long term Working Capital Financing:

Permanent working capital should be financed in such a manner that enterprise can avail the uninterrupted use of fund for a long period.

I. **Shares**: Shares are prime source of financing the fixed working capital. Shares are also treated as ownership securities. The capital of company is divided into a number of equal parts is known as share. According to Farewell, a share is “The interest of share holder in a company measured by a sum of money for the purpose of liability in first place and of interest in second but also consisting a series of mutual convenants entered into by all share holder interest. A company can issue various type of share as equity share, preference share, deferred share etc. Preference share carry preferential rights in payment at a fixed
rate of dividend is paid per year. Equity share does not have any fixed liable charges. Dividend depends upon availability of profit. Big companies raise maximum by issue of shares.

2. Debentures: A debenture is an instrument issued by company acknowledging its debt to its holder. It is very important source of financing fixed working capital requirement without any ownership but by creditorship. It is also known as Debt capital or Bond. A debenture is acknowledge of debt. According to Thomas Evelyn “A debenture is a document under the company seal which provide for the payment of a principle sum and interest there on at regular intervals, which is usually secured by a fixed or floating charges on company property or undertaking and which acknowledge loan to the company.”

A debenture holder is creditor to the company. A fixed rate of interest is paid on debenture. There are so many kind of debenture popular among them are Redeemable, Secured, Mortgage, Covertable debenture. Since interest on debenture have paid on certain predetermined intervals at a fixed rate and also debentures get priority on repayment at the time of liquidation, they are very well suited to various investors. The firms issuing debenture also enjoy a number of benefits such as trading on equity, retention of control, tax benefits etc.

3. Public Deposite: Public deposite are fixed deposite accepted by a business enterprise directly from the public. Companies accept deposite directly from the public offering higher interest rate as compared to banks and post office to meet their requirement of funds. Inspite of public deposite are unsecured, more risky, less liquid and without any tax advantage there has been a tremendous growth both in the amount of public deposite and number of companies offering such deposite. Acceptance of public deposite by corporate sector in many cases has been found to encourage non-priority sectors of production and defect the very purpose of the restrictive credit policy of the Reserve Bank Of India. The primary objective of exercising control over public deposite has been to regulate the growth of deposite outside the banking sector as well as to provide protection to the
investor in such deposite. Public deposite are for the period of 6months to 1 year. But now a days long term deposite for 5 to 7 years are accepted by business houses. Public deposite are simple, convenient source of finance enjoying tax benefits, no need of securities and inexpensive source of finance. Non banking concern cannot borrow by way of public deposits more than 25% of paid up capital and free reserves.

4. Ploughing Back of Profit: It means reinvestment of concern of its surplus earning in the business. It is an internal source of finance. The technique of financial management where profits are retained in the company. The process of retaining profits year after year and their effective utilisation in the business is known as ploughing back of profit. It is like a process used by farmer from their produced grain they retained some amount of grain as seed for next period. This phenomenon is also known as self financing or inter financing or internal financing. Ploughing back of profit help in replacing old assets, expansion and growth of business, improving efficiency of plant and machinery for self dependent and redemption of loan and debenture.

Ploughing back of profit depends upon earning capacity of firm as well as their policy regarding dividend and taxation. On one side ploughing back is a economic mode of financing help in smooth running of business make company self dependent on the other hand it over capitalised and create monopolies.

5. Loan From Financial Institutions: This source of finance is more suitable to meet the medium term demand of working capital. There are special financial institutions which are also called as development banks. They provide finance as well as promote new enterprises too. At present IDBI, ICICI, IFCI, SFC, IRCI, SIDDI are working in the country.

Such institutions helps in promoting new ventures, expansion and development of existing companies and meeting the financial requirement of company.

Advantage:

1. Availability of finance for development.

2. Finance available during period of depression.
3. Easy payment facility.

4. Underwriting facility.

5.2.2 Short Term or Temporary Working Capital Financing:

Temporary working capital are short term requirement. Enterprises has too many path to finance its temporary financing of working capital needs some of them are detailed below.

1. **Trade Credit**: Trade Credit refers to the credit extended by the suppliers of goods in normal course of business. In present yera a commerce is build upon credit, the trade credit arrangement of firm with its supplier is an important source of finance. Most of the trade credit is extended on open account basis where supplier send its goods to the buyer and payment to be received in future as per terms and conditions agreed upon.

   Delay in payment beyond due date is termed as stretching account payable. In case of stretching account buyer has to pay penal interest as well as cash discount also laps.

**Concluding Trade Credit**:

* The cost of trade credit is very high beyond the discount period and unless firm is hard. Pressed financially it should not forego the discount for prompt payment.

* It impair the credit worthiness of the firm as well as discount in conditions of non payment on due date.

2. **Advance**: Monopolistic type of concern gets advances from their customer and mideries against the order place by them, this source is a short term source of finance for them. Some business concern which works on order, takes advances from the buyer as per prior requirement to fulfill short term working capital.

3. **Indigenous Bankers**: Private money lenders and other country bankers used to be the only source of finance prior to establishment of commercial bank.
They charge very high rate of interest and exploit the customer as much as possible. Though in modern era this practice is seen very low but some business concern still depend upon this source.

4. **Accruals**: The major accrual items are wages and salaries. These are simply what firm owes to its employee and to the government. Accruals vary with the level of activity of firm. Increase in activities, rise the level of accruals. Accrual are treated as a part of spontaneous financing. While accruals are a welcome source of financing they are typically not amenable to control by management.

5. **Installment Credit**: This is another method by which the assets are purchased and the possession of goods is taken immediately but the payment is made in installment over a predetermined period of time. Infant is charged an residual balance remain for paying. The fund kept may be used as a source of short term working capital by business house.

6. **Commercial Bank**: Banks are the most important sources of short term capital. The major portion of working capital loan are provided by commercial bank.

**Commercial bank normally offers:**

(a) **Loan**: When bank makes an advance in lumpsum against some security it is called loan. The entire loan amount is paid to the borrower either in cash or by credit to his account. A loan may be repayble in lumpsum or installment.

(b) **Cash Credit**: A cash credit is an arrangement by which bank allows his customer to borrow money upto a certain limit against some tangible securities or guarantees. The interest charge on cash credit is on daily balance and not on the entire amount of account.

(c) **Over Drafts**: It is an agreement with bank by which a current account holder is allowed to withdraw more than the balance to his credit upto a certain limit.

(d) **Purchasing & Discounting of Bills**: This is done by bank without any collateral security. The seller draw bill of exchange on the buyer of goods on credit.
The bank purchase the bill on demand and credits the customer account with amount of bill less discount. At maturity bank present bill for payment.

7. **Commercial Paper**: Commercial paper represents short term unsecured promissory notes issued by the firm which enjoy a fairly high credit rating. Generally, large firm with considerable financial strength are able to issue commercial paper.

**Features:**

* Maturity period 60 to 180 days.
* Commercial paper is sold at a discount from its face value.
* Directly placed with investor.
* Commercial paper is usually bought by investors who intent holding it till its maturity.

8. **Deffered Income**: Deffered incomes are income received in advance before supply of good or services. They represents funds received from for its has to supply goods or services in future. However firms having great demand of goods and services and those having good reputation in market demand deffered income.

9. **Factoring**: A factor is a financial institutions which offers services relating to management and financing of debt arising from credit sales. Factoring is becoming popular all over the world on account of various services offered by institution as engaged in it. Factoring may be on resource basis, where the risk of bad debts is borne by client or on a non-resource basis, where risk of credit is born by the factor. In India few companies are rendering factoring on a recourse basis.

**Features of a Factoring Arrangement:**

Key features of a factoring arrangement are as follows:

* The factor selects the accounts of the client that would be handled by it and establishes along with the client, the credit limits applicable to the selected accounts.
* The factor assumes responsibility for collecting the debt of accounts handled by it.

* The factor advances money to the client against not-yet-collected and not-yet-deducted.

* Factoring may be on a recourse basis (this means that the credit risk is borne by the client) or on a non-recourse basis (this means that the credit risk is borne by the factor). Present factoring in India typically done on a recourse basis.

* Besides the interest on advances against debts, the factor charges a commission which will be 1 or 2 per cent of the face value of the debt factored.

The Mechanics of factoring are illustrated below:

[Diagram of the Mechanics of Factoring]

Mechanics of Factoring

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Advantage of Factoring:

1. Factoring ensure definite pattern of cash inflows from credit sales.
2. Continuous factoring may virtually eliminate the need for the credit and collection department.

Limitations of Factoring:

1. The cost of factoring tends to be higher than the cost of other forms of short borrowing.
2. Factoring of debt may be perceived as a sign of financial weakness.
5.3 Financing of Working Capital in Grasim Cement, Raipur

In this unit, working capital has been financed in the following ways:

(i) Debentures:

Head Office (H.O.) issued Non Convertible Debentures for the purpose of financing fixed working capital. 1000, 13.5% Debentures of Rs. five lacs each have been allocated by H.O. to this unit. Debentures are secured by *paripassu* first charge on fixed assets. This source of finance has a number of advantages both to investors as well as the company. Investors get fixed interest on debentures on predetermined intervals and priority of repayment at the time of liquidation. This company also enjoys various benefits such as trading on equity, retention of control and tax benefits.

(ii) Cash Credits from Banks:

This unit finances its short term requirements of working capital by obtaining cash credit from commercial banks which are SBI, Raipur branch, SBI Mumbai, Central Bank Raipur and UCO Bank, Raipur.

Cash credit is most popular method of financing. A cash credit is an arrangement by which a bank allows its customers to borrow money against some tangible securities or guarantee. He is allowed to withdraw funds from the bank upto the sanctioned credit limit. He also has an option to draw periodically to the extent of his requirements and reply by depositing surplus funds in his cash credit account. There is no commitment charge, therefore interest is payable on the amount actually utilized by the customer.

Cash Credit limits are sanctioned against the security of current assets. The mode of security in this case is hypothecation where bank provides working capital finance against the security of book debts and inventories. The unit does not give possession of property to the bank. It remains with the unit as hypothecation is merely charge against property for the amount of debt. The rights of hypothecatee (lending bank) depend upon the terms of contract between the unit and the bank has the legal right to sell the goods in case the amount of loan is outstanding. The maximum sanctioned limit in this case is 33% of the value of stock. The cash creditors are also secured by the negative lien on other assets.
5.1 Calculation of Working Capital Requirement of Grasim Cement:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>As on 31 Mar.00</th>
<th>As on 31 Mar.01</th>
<th>As on 31 Mar.02</th>
<th>As on 31 Mar.03</th>
<th>As on 31 Mar.04</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Current Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash &amp; Bank balance</td>
<td>1742.47</td>
<td>1584.06</td>
<td>832.68</td>
<td>860.48</td>
<td>774.43</td>
</tr>
<tr>
<td>Raw material</td>
<td>243.27</td>
<td>221.15</td>
<td>275.09</td>
<td>250.39</td>
<td>225.35</td>
</tr>
<tr>
<td>Finished Goods</td>
<td>1101.82</td>
<td>1001.65</td>
<td>752.61</td>
<td>487.55</td>
<td>438.80</td>
</tr>
<tr>
<td>Process Stock</td>
<td>91.99</td>
<td>83.63</td>
<td>249.56</td>
<td>640.59</td>
<td>576.53</td>
</tr>
<tr>
<td>Waste/Scrap</td>
<td>9.92</td>
<td>9.02</td>
<td>8.92</td>
<td>6.15</td>
<td>5.54</td>
</tr>
<tr>
<td>Stores, Spares &amp; packing</td>
<td>3504.25</td>
<td>3185.68</td>
<td>2846.6</td>
<td>1970.97</td>
<td>1773.87</td>
</tr>
<tr>
<td>Sundry debtors</td>
<td>6061.93</td>
<td>6238.12</td>
<td>4797.56</td>
<td>3651.3</td>
<td>3286.17</td>
</tr>
<tr>
<td>Loan &amp; Advance</td>
<td>1599.20</td>
<td>1453.82</td>
<td>1291.75</td>
<td>1146.28</td>
<td>1031.66</td>
</tr>
<tr>
<td>TOTAL (A)</td>
<td>15154.843</td>
<td>13777.13</td>
<td>11054.77</td>
<td>9013.71</td>
<td>8112.339</td>
</tr>
<tr>
<td>(B) Current liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sundry Creditors</td>
<td>2658.03</td>
<td>2416.39</td>
<td>1762.2</td>
<td>2608.77</td>
<td>2347.89</td>
</tr>
<tr>
<td>Security &amp; other deposits</td>
<td>641.06</td>
<td>582.78</td>
<td>746.13</td>
<td>945.56</td>
<td>851.00</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>525.79</td>
<td>477.99</td>
<td>498.67</td>
<td>551.1</td>
<td>495.99</td>
</tr>
<tr>
<td>TOTAL (B)</td>
<td>3824.876</td>
<td>3477.16</td>
<td>3007</td>
<td>4105.43</td>
<td>3694.887</td>
</tr>
<tr>
<td>WORKING CAPITAL (A-B)</td>
<td>11329.967</td>
<td>10299.97</td>
<td>8047.77</td>
<td>4908.28</td>
<td>4417.452</td>
</tr>
</tbody>
</table>
5.4 WORKING CAPITAL RATIO:

A ratio is a simple arithmetical expression of the relationship of one number to another. It may be defined as the indicated quotient of two mathematical expressions. According to Keli and Bedford, a ratio "is an expression of the quantitative relationship between two numbers".

Ratio analysis is a techniques of analysis and interpretation of financial statements. It is the process of establishing and interpreting various ratios for helping in making certain decisions. Calculation of ratio's doesn't serve any purpose, unless several appropriate ratios are analysed and interpreted. It is one of the most powerful tools of financial analysis, it has wide applications and is of immense use today. The technique of ratio analysis is employed here to measure short term liquidity or working capital position of the firm.

5.4.1 Steps of Ratio Analysis:

Following are the four steps involved in ratio analysis -

(i) Selection of relevant data from financial statement.

(ii) Calculation of appropriate ratios from the above data.

(iii) Comparison of calculated ratios with ratio of this firm only in the past; and

(iv) Interpretation of Ratios.

Financial Classification in View of Financial Management:

- Liquidity Ratios
- Long Term Solvency & Leverage Ratios
- Activity Ratios
- Profitability Ratios

We will deal with Liquidity and Activity Ratios which are connected with the evaluation of working capital.
5.4.2. Liquidity Ratios:

Liquidity refers to the ability of the company to meet its current obligations as and when these become due. The short term obligations are met by realising amounts from current, floating or circulating assets. The current assets should either by liquid or near liquidity to be converted into each for paying obligations of short term value. This includes:

(i) Current Ratio.

(ii) Acid Test Ratio.

(iii) Absolute liquid Ratio.

(i) Current Ratio:

Current Ratio may be defined as the relationship between current assets and current liabilities. This is also known as working capital ratio and is a measure of general liquidity-most widely used to make analysis of short term financial position of the company.

\[
\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}
\]

A relatively high current ratio is an indication that the firm is liquid and has ability to pay its current obligations in time as and when they become due. As a convention the minimum of “two to one” is referred to as a banker’s rule of thumb or arbitrary standard of liquidity for a firm. The idea of having double the current assets as compared to current liabilities is to provide for delays and losses in the realization of current assets. It represents the margin of safety or ‘cushion’ to creditors and other current liabilities.

(ii) Quick or Acid Test or Liquid Ratio:

Quick Ratio may be defined as the relationship between quick/liquid assets and current liabilities. It is a more rigorous test of liquidity than current ratio as current assets include inventories and prepaid expenses which are not easily convertible into cash within a short period. Liquid assets include cash in hand and
at bank, Bills receivable, sundry debtors, marketable securities and short-term temporary investments.

\[
\text{Quick / Acid Test/Liquid ratio} = \frac{\text{Quick or Liquid Assets}}{\text{Current Liabilities}}
\]

Usually, a high acid test ratio is an indication that the firm is liquid and has the ability to meet its current liabilities in time. As a rule of thumb, quick ratio of 1:1 is considered satisfactory. But it should be used cautiously. A quick ratio of 1:1 does not necessarily mean satisfactory liquidity position if all the debtors can not be realised and cash is needed immediately to meet the current obligation.

(iii) Absolute Liquid Ratio:

Although receivables, debtors are generally more liquid than inventories, yet there may be doubts regarding their realisation into cash immediately or on time. Hence, absolute liquid ratio is calculated together with current ratio and acid test ratio so as to exclude even receivables from the current assets.

\[
\text{Absolute Liquid ratio} = \frac{\text{Absolute liquid assets}}{\text{Current Liabilities}}
\]

Absolute liquid assets include cash in hand and at bank and marketable securities or temporary investments. The acceptable norm for this ratio is 1:2 as all the creditors are not expected to demand cash at the same time and then cash may also be realised from debtors and inventories.

5.4.3 Activity Ratios/Efficiency Ratios/Current Assets Movement Ratios:

Funds are invested in various assets in business to make sales and earn profits. The efficiency with which assets are managed directly affect the volume of sales. The better the management of assets, the larger is the volume of sales and the profits. Activity ratios measure the efficiency or effectiveness with which a firm manages its resources or assets. These ratios are also called turnover ratio because they indicate the speed with which assets are converted or turned over into sales.
(i) **Inventory Turnover/Stock Turnover Ratio:**

Every firm has to maintain a certain level of inventory so as to be able to meet the requirements of business. But the level of inventory should neither be too high nor too low. Inventory turnover ratio indicates whether inventory has been efficiently used or not. The purpose is to see whether required minimum funds have been locked up in inventory.

\[
\text{Inventory Turnover Ratio} = \frac{\text{Net Sales}}{\text{Average Inventory}}
\]

A high inventory turnover indicates efficient management of inventory because more frequently the stocks are sold, the lesser amount of money is required to finance the inventory but this may not always be the case as a very high inventory turnover does not necessarily imply higher profits. There are no "rule of thumb" for interpreting this. The norms may be different for different industries.

(ii) **Inventory Conversion Period:**

It gives the average time taken for clearing the stocks. It is calculated by dividing the number of days by inventory turnover.

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

(iii) **Debtors/Receivable Turnover Ratio:**

A company may sell goods on cash as well as credit. But a liberal credit policy may result in building up trade debtors which are included in current assets. Here, debtors turnover ratio indicates velocity of debt collection of firm.

\[
\text{Debtors Turnover/Velocit} = \frac{\text{Annual Credit Sales}}{\text{Trade Debtors}}
\]

Debtors include Bills receivable also and are taken at gross value. The higher the value of debtors turnover, the more efficient is the management of debtors/
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\text{Debtors Turnover/Velocity} = \frac{\text{Annual Credit Sales}}{\text{Trade Debtors}}
\]

Debtors include Bills receivable also and are taken at gross value. The higher the value of debtors turnover, the more efficient is the management of debtors/
sales or more liquid are the debtors. Generally this ratio is compared for different periods and then interpreted.

(iv) **Average Collection Period Ratio:**

This represents the average number of days for which a firm has to wait before its receivables are converted into cash.

\[
\text{Average Collection Period} = \frac{\text{No. of Working Days}}{\text{Debtors Turnover Ratio}}
\]

It measures the quality of debtors. The shorter the average collection period the better is the quality of debtors as a short collection period implies quick payment by debtors as longer the collections period, there are more chances of bad debts.

(v) **Creditors/Payable Turnover Ratio:**

In course of business operations, a firm has to make credit purchases and incur short term liabilities. Creditors is interested in finding out how much time the firm is likely to take in repaying it trade creditors. The ratio indicates the velocity with which the creditors are turned over in relation to purchases. The higher the creditors velocity, the better it is

\[
\text{Creditors Turnover Ratio} = \frac{\text{Net Credit Purchases}}{\text{Trade Creditors}}
\]

(vi) **Average Payment Period Ratio:**

It represents the average number of days taken by the firm to pay its creditors. The lower the ratio, the better is the liquidity of the firm. To make correct interpretation of this ratio is found out for various years.

\[
\text{Average Payment Period Ratio} = \frac{\text{No. of Days in a year}}{\text{Creditors Turnover Ratio}}
\]
(vii) **Working Capital Turnover Ratio:**

This indicated the velocity with which net working capital is utilized. That is, the number of times the working capital is turned over in the course of a year.

A higher ratio indicated effective utilization of working capital. But a very high working capital turnover ratio is not a good situation for any firm.

\[
\text{Working Capital Turnover Ratio} = \frac{\text{Cost of Sales}}{\text{Net Working Capital}}
\]
## 5.2 Ratio’s Calculation of Grasim Cement:

<table>
<thead>
<tr>
<th>Ratio Type</th>
<th>99-00</th>
<th>00-01</th>
<th>01-02</th>
<th>02-03</th>
<th>03-04</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(a) Liquidity ratio</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Current ratio</td>
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<td>Current Assets</td>
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<td>3477.15</td>
<td>3007.01</td>
<td>4105.36</td>
<td>3694.89</td>
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<td>2. Acid Test ratio</td>
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<td>Liquid Assets</td>
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<td>Current liabilities</td>
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<td>3477.15</td>
<td>3007.01</td>
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<td>3694.89</td>
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<td>Current liabilities</td>
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<td><strong>(b) Activity ratio</strong></td>
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<td>1. Inventory turnover ratio</td>
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<td>Net sales</td>
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<td>26075.46</td>
<td>30075.69</td>
<td>27711.44</td>
<td>31011.75</td>
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<td>3. Debtors turnover ratio</td>
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<td>Credit sales</td>
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<tr>
<td>No. of Working Days</td>
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<tr>
<td>Debtors turnover ratio</td>
<td>3.17</td>
<td>3.13</td>
<td>4.7</td>
<td>5.7</td>
<td>7.09</td>
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<td>5. Working Capital Turn Over Ratio</td>
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<td>Cost Of sales</td>
<td>2206.60</td>
<td>2008</td>
<td>2284</td>
<td>2152</td>
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<td>Net Working capital</td>
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<td>0.283804289</td>
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</table>
Analysis of Table 5.1:

The Working Capital in the year 1999-2000 has been reduced by about 60% which is a positive sign. The reasons responsible for this are given below.

(i) The amount of cash and bank balances maintained by the unit has come down.

(ii) Finished goods stock has been brought down by supplying the dealers at required time.

(iii) Stores and Spare parts has been reduced by discarding of obsolete items and devising new and proper techniques of maintenance, better contact with transporters for timely delivery.

(iv) Debtors are also on diminishing curve partly due to the fact that last year marketing division eas separated from this manufacturing unit at Raipur. This change was made as a step towards better management of units by Head Office.

(v) Creditors were less in the year 1998-99 but again increased in 1999-2000 due to rising goodwill of the company, the suppliers are ready to give longer credit period.

(vi) Security deposits have also increased considerably which has also contributed to decreasing working capital.

Analysis of Table 5.2:

(i) Current ratio in the year 1999-00 was high as compared to conventional rule of 2:1. In the year 2001-02 was brought down slightly and in the year 2003-2004 it was controlled effectively and was very near to rule of thumb which signifies highly satisfactory situation.

(ii) Acid Test Ratio also follows the same trend. In the year 1999-00, it was more than double the rule of thumb of 1:1, in 2001-02 it was reduced a little and was ideal in the year 2003-2004 revealing that the unit is liquid.

(iii) The acceptable norm for Absolute Liquid Ratio is 50% and is the case in the
year 99-00. In 01-02 and as well as 03-2004, it was very low which shows a tight cash situation.

(iv) **Inventory Turnover Ratio or Stock Velocity Ratio** has improved in 03-2004 as compared to earlier years which tells us that inventory has been efficiently managed. In addition to the Inventory Conversion period is also shortened giving a better picture of stock movement.

(v) **Debtors Turnover Ratio** is on a rise in 03-2004 to 7.08 as compared to 4.7 and 3.17 in the year 99-00 respectively i.e. the unit has well managed its debtors. Average collection Period shows a declining trend in 03-2004 which implica efficiency collection performance. This is the combined date for manufacturing and Marketing Division.