CHAPTER-2
CONCEPTUAL FRAMEWORK OF WORKING CAPITAL

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2.1 INTRODUCTION

The funds required by every business organization can broadly classify into fixed capital and Working Capital. Fixed capital is needed for the acquisition of fixed asset. Fixed assets constitute of basic tools of the means of production. Investment in fixed assets by itself is dead investment and the funds so locked up do not circulate continuously. Every business organization requires some funds to carry on its operations and to produce goods for sale to earn profit. These funds which are represented by the current capital used through the various steps of production and distribution and are invested in C.A..

The management of Working Capital is by no means an easy task but presents stimulating challenges to the financial executive. It requires his constant attention and exercise of skill and judgment through knowledge of business on awareness of economic trends and familiarity with the money market.¹

The management of Working Capital calls for careful shortage cash flow budgeting based on sound operating budgets variance analysis at regular intervals, careful control of credit and collection period the proper handling of inventory. It also calls for judicious handing of funds not otherwise employed and proper use of banks advances to finance seasonal requirements of the business or for its expansion planning. The study of Working Capital management occupies an important place in financial management. It has never received so much attention as in recent years. Working Capital management is an integral part of overall financial management Working Capital management has been looked as the driving seat of a financial manager.²

Reserve bank of India has made a survey of 1930 companies during 1996 and 1997 and presented its conclusion. As per to its study average 45% of the total capital investment of these companies is in Working Capital. In the industries like Tea, Rubber, Coffee etc. the
average ratio of Working Capital is around 60% to 80% and in the Electricity and Engineering industries this ratio is around 40%. According to the viewpoint of financial decision Working Capital is said to be an important aspect.

2.2 CONCEPT OF WORKING CAPITAL

Working Capital management defined as the management of C.A. and the sources of their financing. An enterprise needs not only fixed capital but also Working Capital. The Working Capital is the capital needed to conduct the day to day operations of a business. Working Capital is a border term, therefore in the financial and accounting world the term Working Capital is often misunderstood. There seems to be no unanimity in the concept of Working Capital amongst its users. It either lacks correct understanding or perhaps the users, lack of uniformity in the application of this term. This is an established fact because Working Capital is not shown in account form in the financial statement. Due to the disagreement some financial experts are of the view that it better to avoid the expansion of Working Capital altogether.³

According to several experts in the field of finance accept that the term Working Capital may be defined on the basis of two concepts as follows:

(1) Net Working Capital.
(2) Gross Working Capital.

Net Working Capital is the difference between C.A. and current liabilities, while gross Working Capital is the amount of funds invested in C.A. that are employed in the business process.

As per Prof S. C. Kuchhal, “The Net Working Capital concept is a long run view the operation of C.A. which is constant in short run analysis and decision making but variable and manageable in long run operation.”⁴
From the management of view ‘Gross Working Capital’ is of paramount interest as it not only shows firm’s credit worthless but is based on going concern concept. It is these assets that financial managers are concerned with if they are to bring productivity from other assets and to realize the greatest return on investment. Management has to pay attention to the total amount of C.A. and their profit earning capacity so that it is higher than cost of borrowings.\(^5\)

Net Working Capital means the difference between book value of C.A. and current liabilities. Cash, bank balance, securities easily salable debtors, bills receivables, loans deposits etc are C.A.. Creditors, bills payables, expenses required to be paid, short term loan, income received in advance, bank loan, overdrafts etc are the current liabilities.

It can be concluded that both the concepts are useful and are applied keeping in view the purpose of the users.

By nature Working Capital is short term capital because essentially it meets the short – term financial requirements of a business enterprise. Normally this capital is hardly retained longer than a year. As opposed to fixed capital the amount invested in it is not permanently blocked but the investment changes in form and substance during the normal business operations, so money invested in it is circulating or floating.\(^6\)

The main arguments in favor of the concept of gross Working Capital are as under:

1. There are two types of assets of a company fixed assets and C.A.. Similarly there are two types of capital; fixed capital and Working Capital. Fixed assets constitute the fixed capital of a company. Hence logic demands that C.A. should be considered as the Working Capital of the company.
2. Use of the amount of loan is mostly made for the purchase of C.A. and loan is treated as source of short term Working Capital.
(3) For keeping fixed assets in working condition, C.A. are required. Therefore calculation of C.A. is very important.

(4) Every management is interested in the total C.A. as it has to continue smoothly the operation of the enterprise. They are not much interested in the sources of capital. Total of C.A. is a more useful concept for them.

(5) No special changes take place in company’s fixed assets. But to keep the accounts of the C.A. is very important because often changes take place in C.A..

According to the Net Working Capital thought advocated by such authorities as Lincoln, Stevens and Saliers are as under:


The arguments of this school of thought, regarding Working Capital as the excess of C.A. over current liabilities are as follows:

(1) This definition of Working Capital is in use since long.

(2) This concept of Working Capital is most useful in times of emergency. Any concern can successfully tide over the period of emergency with the help of its surplus of C.A. which are not to be repaid.

(3) This concept gives an idea of the extent of protection afforded to the share holders and creditors. It also enable them to judge the financial soundness of the concern.

(4) This concept is of great use in comparing the financial position of two companies with an equal total amount of C.A..

To avoid the confusion involved in the interpretation of Working Capital, it is suggested that total C.A. should be described as gross Working Capital, while excess of total C.A. over total current liabilities should be designated as net Working Capital.

It is with the help of Working Capital that fixed assets are utilized without it they remain idle. It is again measure of solvency a firm. An analytical study of liquidity can be made with the help it. Further unlike
fixed assets it is not specialized and does not diminish in value. The control of Working Capital required deep study in cash flows and fund flows.

Working Capital is related with liquidity. Liquidity and profitability are two important and major aspect of business life. No firm can survive, if it has no liquidity. A firm many exist without making profits but cannot survive without liquidity. A firm not making profit may be treated as sick but one having no liquidity may soon meet with its downfall and ultimately die. So there is need of close relationship between liquidity and profitability. But they should be separately recognized and be managed.

The most desirable and least desirable situations for companies to be in are illustrated clearly; the strongest companies will be located in cell 1, where both profitability and liquidity are being achieved. The companies located in cell 4 are unsuccessful and corporate failure is imminent enterprise cannot survive when they are unprofitable and illiquid. Companies die by going in to liquidation and it is worth nothing that this is not necessarily a voluntary action. A question does arise as to whether it is preferable to be located in cell 2 or cell 3. In general the answer is that being located I cell 2 poses a more serious threat to the enterprise. Thus if the company is liquid though unprofitable it will generally being a position to revise its strategy. If the company is profitable but illiquid that may find that it is forced out of business before it gets the chance to correct the problem. So Working Capital Management has thus become a basic and broad measure of judging the performance of a business firm.

Working Capital is as essential as fixed capital in the successful operation of a production unit. In the past only the problems of the management of fixed capital were considered in the study of financial management but now the problem of Working Capital management are also given the same importance. Some authors go to the extent of
saying that financial management means Working Capital management. Even if this extreme view is geared an unacceptable there is no doubts that a large part of a financial manager's find and energy is usual up in attending to the problems of Working Capital management.

2.3 DEFINITIONS OF WORKING CAPITAL

Definitions of Working Capital, as per various management experts are as under:

“Working Capital is the excess of C.A. over current liabilities.”
- Prof. Hanny G, Guthmann and Herbert E. Dougall

“Working Capital is descriptive of that capital which is not fixed. But the more common use of the Working Capital is to consider it as the difference between the book value of the C.A. and current liabilities.”
- Hoagland.

“Working Capital represents the excess of C.A. over current liabilities”
- J.L. Brown and L.R. Housard.

“Working Capital represents only the current capital assets.”
- Meal Baker Malott and Field.

“Working Capital means a sum of C.A..”
- J.S. Mill.

“Working Capital to a firm's investment in short term assets cash short-term securities, accounts, receivables and inventories.
- Weston the Brigham

“A Working Capital deficit exits if current liabilities exceed C.A..”
- Prof. C.W. Gerstoberg.
“Working Capital equals the aggregate value of C.A. minus aggregate value of current liabilities”

- Lincoln.

“Gross Working Capital may be used to refer to total C.A. and net working capital refers to the surplus of C.A. over current liabilities”

- Prof. S.C. Kuchhal

2.4 IMPORTANCE OF WORKING CAPITAL

To satisfy the daily needs of an industrial unit, management should think seriously about Working Capital. Working Capital is such of capital that with the help of which a business remains in working condition. It remains live for any business units, Working Capital can be said to be its life. If there is any error in the estimation of Working Capital there will be risk on production continuity in an industrial unit. It will be difficult to launch a product in time and as a result a company would have to lose the market. On the other hand a company will not be able to make payment to workers and trades in time. Dissatisfaction of workers will increase which will create legal problems for management. Working Capital is also known as Circulating capital or Floating capital.

Working Capital constitutes as large portion of total investment in assets. It is estimated, that about 60% of total net assets of the public sector companies in India is in the form of C.A.. This underlines the importance of Working Capital management.

Working Capital management is more important for the small firm. In the small unit investment in such C.A. as cash, inventories and receivables tends to be larger than investment in fixed assets. It is more difficult for is small units to raise enough long term capital for the C.A..

Working Capital management has acquired important position and great significance in the recent past. It is reflected by the fact that financial manager spend a great deal of time in managing C.A. and
current liabilities. Arranging short term financing, negotiating favorable credit terms, controlling the movement of cash, administering accounts receivables and monitoring the investment in inventories consume a great of their time. “It has been found that the largest portion of financial manager’s time is utilized in the management of Working Capital.”

Weston and Brigham have rightly stated that, “There are many aspects of Working Capital management which make it an important function of the financial manager. On the one hand it maintains proper liquidity while on the other hands it helps in increasing the profitability to the concern.”

Inadequacy or mismanagement of Working Capital is the leading cause of business failure. The Working Capital of a firm is the lifeblood which flows through the veins and arteries of the structure. Working Capital engages every part of the structure, gives courage and moral strength to management and personnel, digests to the best degree the raw material used by its constant and regular flow and return to the cash flow for another journey and so when Working Capital is lacking or slows down, the financial bodies have value just as much as junk.

2.5 OBJECTIVES OF WORKING CAPITAL

The goal of Working Capital management is to manage the concern’s C.A. and current liabilities in such a way that an adequate Working Capital is maintained. Business can get operational flexibility with the help of adequate level of Working Capital. The main objective of Working Capital management is to balance liquidity and profitability. Other objectives of Working Capital management are concerned with the problems that arise in attempting to manage the C.A., the current liabilities and the inter relation ship that exists between them. The objectives of Working Capital management are as under:

1. To maintain smooth and rapid flow of funds in order to increase the efficiency of Working Capital:
When Working Capital is applied to fixed capital a flow of funds results as Working Capital moves from one process to another. It changes from cash to inventories to receivable and back to cash. The smoother and more rapid the flow of funds the more efficient is each rupee of Working Capital. It is because when the flow of Working Capital is smooth and rapid the amount of Working Capital required to produce a given output is less than when interruptions occur which cause the flow to slow down.

2. Availability of ample funds at the times of need:

As a matter of fact a business cannot survive in the absence of a satisfactory ratio between its C.A. and current liabilities. Furthermore its ability to prosper will be largely determined by the composition of the C.A. pool.

3. The maintenance of current ratio between Working Capital and fixed capital:

The management should have as its general financial objective the employment of capital in whatever proportion necessary to maximize productivity and profit. Capital of the business enterprise consists of fixed and Working Capital and the firm’s profitability is determined by the ratio of Working Capital and fixed capital. Other things remaining the same, when Working Capital is increased, the firm’s profitability declines.

2.6 TYPES OF WORKING CAPITAL

Working Capital can be classified either on the basis of its concept or on the basis of periodicity of its requirements, which is as follows:

(A) ON THE BASIS OF CONCEPT:

On the basis of its concept it may be either gross Working Capital or net Working Capital. Gross Working Capital is represented by the
total C.A.. The net Working Capital is the excess of C.A. over current liabilities.


(B) ON THE BASIS OF REQUIREMENT

According to Gerstein Bergh, the Working Capital can be divided into two categories on the basis of time and requirement:

(1) Permanent Working Capital

It refers to the minimum amount of investment which should always be there in the fixed or minimum C.A. like inventory, accounts receivable or cash balance etc, in order to carry out business smoothly. The investment is of a regular or permanent type and as the size of the firm expands the requirement of permanent Working Capital also increases. Tondon Committee has referred to this of Working Capital as ‘Hard Core Working Capital.’

(2) Variable Working Capital

The excess of the amount of Working Capital over permanent Working Capital is known as variable Working Capital. The amount of such Working Capital keeps on fluctuating from time to time on the basis of business activities. It may again be sub-divided into seasonal and special Working Capital. Seasonal Working Capital is required to meet the seasonal demand of busy periods occurring at stated intervals. On the other hand special Working Capital is required to meet extra ordinary needs for contingencies. Events like strike fire, unexpected competition, rising price tendencies or a big advertisement campaign require such capital.

Working Capital cycle indicates the length of time between firms’s paying for materials entering into stock and receiving the cash from sale
of finished goods. In a manufacturing concern the duration of time required to complete the sequence of events is called operating cycle.

According to Hunt William & Donaldson, “The Working Capital is required because of the time gap between the sales and their actual realization in cash. This time gap is technically termed as operating cycle of the business.”

2.7 Circulation system of Working Capital

The Working Capital plays the same role in the business as the role of heart in human body. Just like heart gets blood and circulates the same in the body, in the same way Working Capital funds are generated and these funds are circulated in the business. Thus Working Capital is also known as current capital or circulating capital.

Kulkarni has remarked that, “The use of the term circulating capital intends of Working Capital indicates that its flow is circular in nature.”

The funds in a business are obtained from the issue of shares the issue of debentures other long term agreement and from operation of business.

A huge part of generated funds is used to acquire fixed assets; viz plant and machinery, land and building and some other fixed assets, while the remaining part of the generated funds is used for day to day operations of the business. E. g. to pay wages and overhead expenses for the raw material processed. This makes possible the stocking of finished goods by whose sales either accounts receivable are created or cash is received. In this process profits are generated. A part of the profit is used to pay tax, interest and dividends, while the remaining part is ploughed back in the business this cycle goes on constantly throughout the life of business. This cycle continues throughout the life of business.
2.8 Working Capital Cycle

The duration of time required to complete the sequences of events right from purchase of raw material / goods for cash to the realization of sales in cash is called the operating cycle, Working Capital cycle or cash cycle. This cycle can be said to be at the heart of the need for Working Capital. In the words of O.M. Joy, the Working Capital cycle refers to the length of time necessary to complete the following cycle of events:

1) Conversion of cash into raw material.
2) Conversion of raw material into working progress.
3) Conversion of work-in-progress into finished goods.
4) Conversion of finished goods into debtors or bills receivable through sale.
5) Conversion of debtors or bills receivable into cash

The cycle will repeat again and again over the period depending upon the nature of the business and type of product etc. The Working Capital cycle relates to a manufacturing firm, where cash is needed to purchase raw materials and convert raw material into work-in-progress and then work-in-process is converted into finished goods. Finished goods will be sold for cash or credit and ultimately debtors will be realized.

2.9 CHARACTERISTICS OF WORKING CAPITAL

The features of Working Capital distinguishing it from the fixed capital are as follows:

1) Short term needs.
2) Circular movement.
3) An element of permanency.
4) An element of fluctuation.
5) Liquidity.
6) Less risky.
7) Special accounting system not needed.
8) Different proportion for each industry.

1) **Short-Term Needs**

Working Capital used to acquire C.A. which get converted into cash in a short time. In this respect it differs from fixed capital which represents funds locked in long term assets. The duration of Working Capital depends on the length of production process. The time that elapses in the sale and the waiting time of the cash receipt.

2) **Circular Movement**

Working Capital is constantly converted into cash which again turns into Working Capital. This process of conversion goes on continuously. The cash is used to purchase C.A. and when the goods are produced and sold out those C.A. is transformed into cash.

3) **An element of Permanency**

Though Working Capital is a short term capital, it is required always and forever. As stated above, Working Capital is necessary to continue the productive activity of the enterprise. Hence so long as production continues, the enterprise will constantly remain in need of Working Capital.

4) **An Element of Fluctuation**

Though the requirement of Working Capital is felt permanently, its requirement fluctuates more widely than that of fixed capital. The requirement of Working Capital varies directly with the level of production. It varies with the variation of the purchase and sale policy price level and the level of demand also. The portion of Working Capital that changes with production sale price etc. is called variable Working Capital.

5) **Liquidity**

Working Capital is more liquid than fixed capital. If need arises Working Capital can be converted into cash within a short period and
without much losses.

6) **Less Risky**

Funds invested in fixed assets get locked up for a long period of time and cannot be recovered easily. There is also a danger of fixed assets like machinery getting obsolete due to technological innovations. Investment in fixed capital is comparatively more risky. Investment in C.A. is less risky as it is a short term investment. Working Capital includes more of physical risk only and that too is limited. Working Capital involves financial or economic risk to much less extent because the variations of product prices are less severing generally. Working Capital gets converted into cash again and again. It is free from the risk arising out of technological changes.

7) **Special Accounting System Not Needed**

Fixed capital is invested in long term assets; it becomes necessary to adopt various systems of estimating depreciation. On the other hand working capital is invested in short term assets which last for one year only. So it is not necessary to adopt special accounting system for them.

8) **Different Proportion for Each Industry**

In every industry proportion of working capital is different as per type of business and nature of business e.g. In Building or Ship Building Industry proportion if Working Capital is high while in Public Utility Units where services use sold speedily the proportion of Working Capital is less. The proportion of Working Capital changes from industry to industry.

2.10 **FACTORS AFFECTING TO WORKING CAPITAL**

There are a number of features which determine the amount of Working Capital requirement in business. It is not possible to give general principles applicable to all enterprises equally. These factors appraisal is helpful to the management in formulating its sound Working
Capital policies and estimating its needs. Important factors which determine Working Capital are as given below:

1. Nature of Business.
2. Production Time.
3. Production Policies
4. Turnover of Circulating Capital.
5. Terms of Purchase and Sales.
7. Rapidity of Turnover.
8. Condition of Supply.
10. Dividend policy of Concern.

The working capital of the business is decided on the basis of types of business, industry, trade or circulative of the sources is considered. Hence finance is to be obtained at a high rate and it will make company's financial position weaker. To prevent this situation following factors should be taken into account.

(1) **Nature of Business**

According to various form of business, requirement of Working Capital goes on changing. In comparison of manufacturing unit, trade and commerce concern require more Working Capital. Public services like electricity and railway required less Working Capital. Unit engaged in manufactures of luxurious product like air-conditioners required more Working Capital because it has a long operating cycle and which sells largely on credit.\(^{10}\) as per view of *Husband and Dockery*, “The Working Capital position is affected more by business condition and trends than by the nature or the size of the company.”
(2) **Production Time: Time of Production Process**

The level of Working Capital depends upon the time required to manufacture goods. If the time is longer the size of working capital is greater more over the amount of working capital depends upon inventory turnover and the unit cost of the goods that are sold. The greater this cost the bigger is the amount of Working Capital. Plastic Industry, Bakery Industry, Dairy Industry etc. required less Working Capital because the production process is short and less.

(3) **Production Policies**

The nature of production policy also exercises its input on capital needs. Strong seasonal movements have special Working Capital problems and requirements. High level production plan also includes higher investment in Working Capital.

(4) **Turnover of Circulating Capital**

The period required for conversion from goods into cash is known as turnover of capital. It has adverse relation with Working Capital. If the turnover rate of capital is more, less Working Capital will be required and vice-versa. The speed with which the circulating capital completes its round i.e. conversion of cash into inventory of raw material and stores inventory of raw material into inventory of finished goods. Inventory of finished goods into book debts or accounts receivable and book debts into cash accounts plays an important and decisive role in the judging the adequacy of Working Capital.

(5) **Terms of Purchase and Sales**

The place given to credits by a company in its dealing with creditors and debtors affects considerably the amount of Working Capital. Business unit making purchase on credit basis and selling its finished products on cash basis will require a lower amount of Working Capital on the contrary.
Concern having no credit facilities and at the same time forced to grant credit to its customers, may find itself in a tight position. The discretion of management in setting credit terms is affected prevailing trade practices as well as by changing economic conditions.

(6) Growth and Expansion of Business

As company grows it is logical to expect that the larger amount of Working Capital will be required. Growing concerns require more Working Capital than those that are static. The requirement of Working Capital also varies with economic circumstances and corporate practices.

(7) Rapidity of Turnover

Turnover represents the speed with which the Working Capital is recovered by the scale of goods. In certain business sales are made quickly so that stocks are soon exhausted and new purchases have to be made. In this manner a small sum of money invested in stocks will result in sales of a much large amount. It will reduce the requirement of more Working Capital.

(8) Condition of Supply

The inventory of raw material, spares and stores depends on the condition of supply. If the supply is prompt and adequate the firm can manage with small inventory hence the lower requirements of Working Capital. However, if the supply is unpredictable and scant than the firm, to ensure continuity of production, would have to acquire stocks as and when they are available and carry longer inventory on an average. A similar policy may have to be followed when the raw material is available only seasonally and production operations are carried out round the year. In this case the Working Capital requirement of the concern will be higher.
(9) **Requirement of Cash**

The Working Capital requirements of a company are also influenced by the amount of cash required by it. For various purposes, the greater the requirement of cash, the higher will be the Working Capital needs of the company.

(10) **Dividend Policy of the Firm**

If a conservative dividend policy is followed by the management the needs of Working Capital can be next with the retained earnings. Often variations are need of Working Capital to bring about an adjustment in dividend policy. The relationship between dividend policy and Working Capital is well established and most companies declare dividend after a careful study of their cash requirements.

In addition to scope of business components of Working Capital, demand of products, time between order and delivery, reduction in price of stock, transportation facilities, conversion of C.A. into cash, channels of distribution, wage policy, efficiency of management and miscellaneous factors as the affecting factors of Working Capital.

### 2.11 WORKING CAPITAL BUDGET

Efficiency in the use of Working Capital is very important aspect of Working Capital management. The use of budgets to promote, it is very necessary in view of the fact that many concern suffer from too little Working Capital rather than from too much. In preparing the budgets including the requirement of Working Capital, determinants of quantum of Working Capital are taken into consideration.

The conservation of Working Capital which is essential would be affected by the following factors:

1. Better correlation of production and distribution of products.
2. Purchase may be standardized in such a manner as to make the use of existing Working Capital more effective.
3. Economy may be effected in predicting selling and administrative.
4. Adequate maintenance policies may be imitated to conserve Working Capital, to avoid costly delays due to break dawns.
5. Discarded assets may sometimes, he redeemed and slugged.
6. Improvements in selecting credit risked and speeding up collecting decreases the demand for Working Capital from these sources.

2.12 SOURCE OF WORKING CAPITAL

From which source Working Capital is to be obtained can be decided after considering the types of Working Capital. A prudent financial manager is always interested in obtaining the correct amount of Working Capital at the right time, at a reasonable cost and at the best possible favorable terms. To adopt the right source, it is very necessary for him to have a thorough understanding of the firms short – terms funds needs. Market for short term funds required level of liquidity in funds and risk assumption. A firm interested to obtain short – term funds cash has a choice of securing finance from alternative sources – internal as well as external. In making and final choice as regards to sources of Working Capital the relative cost of financing dependability upon the source and flexibility in financial planning must be given due weight age.

Long Term Sources

Requirements of initial Working Capital and the regular Working Capital includes the long term Working Capital. In addition to the minimum level of investment in various C.A. also determines the requirements of long term Working Capital. The regular fixed or permanent part of Working Capital could be financed from borrowed or owned sources. An owned source involves all type of share capital, accumulated reserves and surpluses, depreciation reserves and sales
of idle assets. Borrowed sources include debentures, bonds, long term and the medium term loans.

A. Owned Source:
1. Share Capital
   A new company has to show the amount of Working Capital required for advertisement. Estimate of Working Capital is fixed. While deciding minimum subscription initial Working Capital is obtained by issuing shares. It is not required to be repaid after fixed period like debentures. There is no liability of paying interest at decided rate of percentage. No mortgage of assets at the company is created. Capital in future can be obtained easily.

2. Accumulated Reserves and Surpluses
   This represents the part of profit not distributed among the share holders. The visionary top level management of the corporate unit allocates some portion of the earnings of the corporate unit.

3. Depreciation Reserves
   It constitutes a part of the cost of business operations and consequently represents an expense that is changeable against earnings.

4. Sales of Idle Fixed Assets
   Any idle fixed assets can be sold out and sale proceeds can be utilized for financing the Working Capital needs.

B. Borrowed Sources:
1. Debentures and Bonds
   For the permanent Working Capital the funds can also be obtained through the issue of debentures. But there is limit beyond which issue of debentures is not desirable. Obtaining capital through debentures is also useful in trading on equity. The main drawback of this method is that as the debentures are required to be redeemed after definite number of years. Management has to make provision for its
repayment every year. In India, public limited companies are allowed to raise debts capital through debenture after they have obtained the certificate of commencement of business.

2. **Long Term and Medium Term Loans**

Some national and international financial institution also provides long – term loans. There are two main institutional sources are of long – term loans:

1. Commercial Banks and
2. Specialized Financial Intuitions.

**Short Term Sources:**

The conventional generalizations on the financing of Working Capital suggest that the variable temporary or seasonal Working Capital should be financed from short – term sources. Short – term source comprise trade credit, banks loans and other sources. The size of these sources and the time for which a concern could place its reliance upon them depends upon factors such as trade customers or local practice, credit standing of the firm and the regularity in making payments.

**A. Bank Loans:**

1. **Secured Loans**

Secured loans are the loans protected by pledge of certain securities. The pledged securities are mostly inventories.

2. **Un Secured Loans**

Unsecured loans are usually taken by means of unsecured promissory notes generally for 90 to 180 days.

3. **Bank Over Drafts**

The establishment of over credit facilities with commercial banks enables a firm to obtain seasonal variable or temporary Working Capital from banks.
4. **Bank Credit**

Commercial banks are also principle sources of Working Capital. Commercial banks provide Working Capital in a number of ways like as overdrafts, cash credit, line of credit, term loans etc. This is the most flexible source in comparison to other methods of borrowing when the debt is no longer needed it can be promptly and early reduced. It is also comparatively cheap.

B. **Trade Loans**

Trade creditors are composed of trade payable bills and notes payable, current credit accounts and customer credit. These usually arise out of the delivery of goods or providing of services and have to be liquidated normally within a year. Trade creditors have an important place among the different sources of financing the seasonal variable or temporary Working Capital, and could finance the requirements of these types of Working Capital to a very large extent. The customers are often asked to make some advance payment in cash in view of a contract to purchase. This advance can be utilized in purchasing raw material paying wages and overhead expenses

C. **Other Source:**

1. **Public Deposits:**

The attitude of using public deposits for obtaining long term and short term capital is increasing today. Public deposits are term deposits made by public with companies of 1/2 or 3 years. The general public is invited to deposit their savings with the company for varying periods or rates of interest which are higher than those allowed by commercial banks. Companies generally get public deposits for different period ranging from 6 month to 3 years. It is not advisable to obtain more finance by this method because when any rumor spreads about the company the depositors withdraw their deposits. Hence company is put
into difficulties. According to control of RBI no company can accept public deposit more than 25% of its paid up capital and general reserves.

2. **Private Loans**

   Such loans strengthen the faith of creditors of a business enterprise. Their size happens to be quite inadequate to fulfill the needs to temporary seasonal or variable Working Capital.

3. **Government Assistance**

   Sometimes Central and State government also provide short – term finance on easy terms.

4. **Loans from Directors**

   An enterprise can also obtain loans from its officers, directors managing directors etc. These loans are often obtained of almost negligible rates of interest. Sometimes no interest is charged on term loans can also be obtain from other fellows companies working within the scale group.

5. **Security of Employees**

   If employers are required to make deposits with their employer companies such companies can utilize those amount in meeting their Working Capital needs.

6. **Credit Papers**

   Bills of exchange and promissory notes of shorter duration varying between a month and 5 months are used. These papers are discounted with a bank and capital can be arranged. Accommodation bills are an important method of such finance.

### 2.13 THE PERTINENT ASPECT OF WORKING CAPITAL

The pertinent aspect of working capital may be narrated as under:

1. **Total Amount of Working Capital**

   That is total investment in total C.A.. This should be neither excess nor inefficient, so that proper profitability and liquidity maintain.
This can be attempted in terms of fixed capital as well as total profitability and sales activity.

2. **Quality Aspect of Working Capital**

That is investment in net Working Capital. Net working capital means C.A. less current liabilities. In order to know the strength of liquidity and to examine the risk, this analysis is necessary.

3. **Investment in the Important Components**

In working capital the funds of a business unit is interested in the important components. These are:

1. Cash and Marketable Securities.
2. Investment and Store Items.
3. Receivables.

4. **Financing of Working Capital**

This is to be examining in term of the periodicity of income and the period of availability of funds. So there has been mismatching and to encore the least cost for raising force of Working Capital.

2.14 **FINANCING OF WORKING CAPITAL**

Financing of Working Capital depends upon the nature of Working Capital. Nature wise there are two kinds of Working Capital, viz; permanent and temporary. Permanent Working Capital is required to finance the minimum requirement of inventories raw material working in progress and cash. These assets defector treated as fixed assets because investments in these assets are as permanents as fixed assets. Investment in other assets are treated as temporary Working Capital which is required for seasonal fluctuations and variations. Both the permanent and temporary Working Capital may either be financed through internal sources or through external sources or both.

As per **I.M. Pandey**, for both Working Capitals, “The need of C.A. (Current Assets) arises because of the operating cycle. The operating cycle is a continuous process and therefore the need of C.A. is felt
constantly. But the magnitude of C.A. needed is not always the same. It increases and decreases over time. However there is always a minimum level of C.A. which is continuously required by the firm to carry on its business operations. This minimum level of C.A. is referred to permanent of fixed Working Capital. It is permanent in the same way as the firm’s fixed assets are. Depending upon changes in production and sales the need for Working Capital over and above the permanent Working Capital will fluctuate.”

One of the important tasks of the financial manger is to select an assortment of appropriate source of finance the C.A. As per S.S. Sahay, the total Working Capital needs of a firm are financed by various components of its C.L. (Current Liabilities) and apart from the permanent funds in the firm. To keep operational efficiency as well as reduction in the cost of financing should be the guiding criteria in the choice of the forms of financing. Normally C.A. of a concern is supported by a combination of loans term and short source of financing. The sources of long term financing are shares debentures retained earnings and loans form specialized financial institutions. The long term source of finance provides support for a small part of C.A. need which is called the Working Capital margin. The sources of short – term financing are short – term bank loans, O.D., cash credit facilities etc. The short – term sources of finance referred to also as C.L. which provides the major support for C.A. The real choice of financing lies between short – term and long term financing. For that purpose in practice the matching approach or hedging approach is applied. When the concern follows matching approach long-term financing will be used to finance fixed assets and permanent C.A. Short-term financing to finance temporary or variable C.A. The following figure indicates the concerns investment and financing patterns over time under a matching plan. As the firm’s fixed assets and permanents C.A. level increase the long term financing level also increase. When temporary C.A. levels
increases short – term negotiated financing increases and when the concern has no temporary C.A. it also has no short term negotiated financing.

When the concern follows matching approach long – term financing should be used to finance fixed assets and permanent C.A. The justification for this sort of financing is that since the object of financing is to pay for assets, the financing should be relinquished when the asset is expected to be relinquished. Using long-term financing for short – term assets is expensive. Since it would involve payment of interest during the period the funds are not utilized. Financing permanent C.A. with short term source will be inconvenient and costly. Since arrangements for the new short –term financing will have to be made on continuing basis. It may of times prove risky. At times the firm may not be able to raise funds and its operations may be disrupted or else to save disruption it may have to borrow funds at very inconvenient rates. This short-term financing is less costly than long – term financing. But the former is more risky than later. The choice should naturally involve a tradeoff between risk and return.13

2.15 Principles of Working Capital Management

1. Follows Principles of Cost of Capital
   
   Sources of procurement of Working Capital are various. Each source has a separate cost of capital. Cost of capital is directly related with risk.

2. Principles of Equality Position
   
   As per this principle Working Capital is required to be invested in such a way that it creates equality in every component of Working Capital. E.g. position of raw material is satisfactory but there is shortage of cash this situation is not proper. Use of working capital must be made in such a way that it increases the net value of the firm.
3. **Principles of Maturity of Payment**

On the date of maturity the company must make the payment of its liabilities. By doing this maximum utilization of units funds will be made. For payment of short term debts special arrangement is required to be made. For this purpose investment in quick convertible securities into cash should be made.

4. **Principles of Optimization**

The financial management should utilize Working Capital in such a percentage that maximum return can be obtained on investment. Factors affecting to the Working Capital should be taken into consideration for that purpose. Percentage of Working Capital should be decided on the basis of return on Working Capital and risk. If risk is more return also will be more and vice – versa.

**CONCLUSIONS**

In the present study of Working Capital management the researcher has studied various type of aspect of working capital management. In this chapter researcher studied meaning of Working Capital, types of Working Capital, importance of working capital, objectives of Working Capital, circulation systems of Working Capital, factors affecting Working Capital, source of Working Capital, financing of Working Capital, characteristics of Working Capital etc. For any concern working capital can be said to be its life. It there is any mistake in the estimation of this type of capital there will be risk on production continuity in an industrial unit. Working Capital consists of raw material, cash on hand, readymade material resalable securities, bills of receivables, debtors etc. **John Stewert** calls Working Capital as a circulating capital or floating capital. In addition Working Capital is needed to meet the day to day expenses on wages, salaries, power etc. According to **Hoagland** Working Capital is descriptive of that capital which is not fixed but the more common use of the Working Capital is to
consider it as the difference between the book value of the C.A. and current liabilities.
References
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