CHAPTER - VII

FINANCING OF WORKING CAPITAL IN THE FIVE SELECTED
STATE OWNED AND STATE CONTROLLED COMPANIES
IN THE STATE OF WEST BENGAL
AND ITS APPRAISAL

The management of working capital has two aspects viz, (i) structural and (ii) financial. While on the structural side, the problem is one of optimisation of investment in each component of working capital. On the financial side, it is one of selecting the appropriate source for financing of working capital in keeping with the norms of liquidity and profitability requirements of a company.

In this chapter, therefore, an attempt has been made to examine the techniques of financing that the selected public sector undertakings under the ownership and control of State of West Bengal. Incidentally, it may be stated that investment in working capital (gross) generally account for more than 50% of the investment in total assets of a company+.

+ According to a RBI study on the "Finance of Public Ltd. Companies 1990-91" investment in current assets had been 53.1% of the total investment in the overall net asset of the company. The same had been 54.7% in the year 1989-90 vide RBI Bulletin, December, 1993, p.1404 (computed).
It is possible to identify three different types of sources which are normally used to finance working capital requirements of a firm, viz, (i) long term (ii) short term and (iii) spontaneous sources.

The important sources of long term finance are equity shares, preference shares, retained earnings and debentures.

The short term financing sources include short term credit that a firm has to arrange in advance and also short term bank loan, bank overdraft/cash credit and public deposits etc.

Spontaneous financing refers to automatic sources of short term funds. The major sources of such finance are trade credit (creditor & bills payable, outstanding expenses etc.). Spontaneous sources of finance are apparently cost free though these carry a high degree of risk. Every firm is normally inclined to utilising this source as much as possible and as such it becomes a predominant source of financing working capital. Thus, the real choice of a firm in the matter of financing working capital not covered by spontaneous sources, lies between the selection of short term and long term sources.

The decision as to how much of the working capital is to be financed by long term sources and how much by short term sources depend upon (i) the availability of the source itself (ii) the cost of the source (iii) the risk element in the use of the source and (iv) also upon the liquidity and profitability
trend of the company. Short term financing is generally preferred over long term financing for two reasons: (i) the apparent cost advantage and (ii) secondly, flexibility since it is relatively easy to refund short term funds when there is no scope to use them. But short term sources are normally riskier than long term sources as funds are to be arranged on a continuous basis to pay these off as and when these mature. Hence, the choice lies in the selection of a source, which will ensure a trade off between risk and return for the use of the specific source of fund. On the basis of risk and profitability perception, a firm may adopt, therefore, any one of the following types of policies for financing working capital, viz, (i) Hedging policy (ii) Conservative policy (iii) Moderate policy and (iv) Aggressive policy.

**Hedging Policy:**

Under hedging policy, working capital investment is divided into two segments, viz, (i) fixed or core working capital and (ii) fluctuating working capital. Fixed or core working capital is sought to be financed by long term sources and fluctuating working capital by the use of short term sources, which though has a cost advantage but carries a high degree of risk in it, as the maturity of floating current asset may not consider with the maturity of a short term debt. This policy is normally suggestive of utilizing predominantly long term sources
for financing working capital thereby eliminating the risk associated with the use of short term sources for financing working capital requirements.

**Conservative Policy:**

It is characterised by the use of exclusively long term sources for financing working capital. The conservative policy aims at avoiding the use of short term sources of finance for complete elimination of risk element inherent in using new short term funds. This policy, no doubt, provides the safest course of action but it has the limitation of having an adverse impact profitability. This type of financing policy is characterised by infinite current ratio.

**Moderate Policy:**

A moderate policy of financing working capital requirements follows a middle path in the use of long term and short term sources of finance for working capital purposes. Under this policy, the approach is one of striking a balance between the risk and profitability. Such a financing policy has the advantages of moderating risk as evidenced by a current ratio of 2:1.

**Aggressive Policy:**

An aggressive working capital financing policy, aims at avoiding the use of long term sources of finance for financing
working capital with the object of increasing the return on equity. An aggressive financing policy is characterised by high degree of risk as the entire working capital is sought to be financed by short term sources with high degree of risk and apparently low cost of financing. Another important features of this policy is a low current ratio, much below the 2 : 1 norm.

From the discussion so far made it is crystal clear that a firm can use two types of sources, viz, (a) long term and (b) short term for financing its working capital requirements.

With these in the background in the discussion that follows, an attempt is made to study the working capital financing practices of the selected public sector undertakings under the ownership and control of the government of West Bengal by locating the ratio between different sources of finance and the total working capital investment in them.

It is assumed in the analysis that a firm uses the long term sources, ownership and/or borrowed, to finance the fixed assets. It is only the surplus of long term sources that are available after financing the fixed assets that is used to finance the working capital. Normally therefore for financing working capital more and more of reliance is on short term sources of finance. Based on this hypothesis, an analysis has been done in the present study to trace the ratio between the different sources of finance, long term and short term, and the current
assets of the sample companies in order to make an appraisal of their working capital financing practices.

The present exercise reveals that the long term sources of finance for the state owned public sector undertakings in West Bengal are equity issues and long term loans, secured and unsecured. Keeping with the basic characteristics of public enterprises, preference shares cannot normally be expected to have any role to play in the capital structure of these units and in the cases of state owned undertakings in West Bengal there has not been any exception to this general norm.

**Equity/Working Capital Ratio**

The use of equity in the financing of working capital has the advantage that it does not immediately affect the short term liquidity of a firm, though it is regarded as the high cost capital. The holder of equity shares in the cases of selected state enterprises in West Bengal, except West Bengal Electronics Industrial Development Corporation Ltd. where 6.25% of total equity is held by West Bengal Industry Development Corporation Ltd. The unit-wise equity/working capital ratio in the companies under analysis has been projected in the Table 53 of the study that follows:
Table - 53: Showing the Role of Equity in Financing Working in Some Selected Sample Companies Under the Ownership and Control of the State Government Undertakings Over a Period Between 1980-81 to 1989-90

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<tr>
<td>The Durgapur Project Ltd.</td>
<td>0.15:1</td>
<td>0.12:1</td>
<td>0.10:1</td>
<td>0.09:1</td>
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<tr>
<td>The Durgapur Chemicals Ltd.</td>
<td>0.77:1</td>
<td>0.66:1</td>
<td>0.61:1</td>
<td>0.54:1</td>
<td>0.70:1</td>
<td>0.65:1</td>
<td>0.87:1</td>
<td>0.72:1</td>
<td>0.77:1</td>
<td>0.69:1</td>
<td>0.70:1</td>
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<td>The west Dinajpur Spinning Mills Ltd.</td>
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<td>The Kalyani Spinning Mills Ltd.</td>
<td>0.20:1</td>
<td>0.95:1</td>
<td>1.03:1</td>
<td>1.50:1</td>
<td>1.49:1</td>
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<td>1.03:1</td>
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<tr>
<td>West Bengal Electronics Industry Development Corporation Ltd.</td>
<td>0.50:1</td>
<td>0.78:1</td>
<td>0.65:1</td>
<td>0.75:1</td>
<td>0.97:1</td>
<td>0.91:1</td>
<td>0.71:1</td>
<td>0.58:1</td>
<td>0.57:1</td>
<td>0.52:1</td>
<td>0.69:1</td>
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Source: Annual Report of the Companies Result computed
The **Durgapur Project Ltd.** :

It would be observed from the Table that in the case of Durgapur Project Ltd. equity/working capital ratio did fluctuate between $0.01:1 (88.89)$ as the minimum and $0.15:1 (80.81)$ as the maximum and with an average of $0.10:1$ over the period under study. This means that the company had more than 10% of its finance for working capital out of equity.

The **Durgapur Chemicals Ltd.** :

In this company equity/working capital ratio varied between $0.54:1 (1983-84)$ and $0.87:1 (1986-87)$ and on an average this ratio had been $0.70:1$. This indicates that the company had sufficient equity finance as against investment in working capital.

The **West Dinajpur Spinning Mills Ltd.** :

The equity/working capital ratio in this company had been in the range between $0.20:1 (1985-86)$ as the minimum and $1.50:1 (1988-89)$ as the maximum and with an average of $1.03:1$. On the face of this it appears that the equity/working capital ratio in the company had been rather high.

The **Kalyani Spinning Mills Ltd.** :

In this company the equity/working capital ratio
varied between 0.50 : 1 (1980-81) and 0.97:1 (1984-85) with an average of 0.69:1. In this company also, therefore, sufficient equity finance was available for working capital purposes.

West Bengal Electronics Industry Development Corporation Ltd.:

In this company equity/working capital ratio had been in the range between 0.15 : 1 (1981-82) as the minimum and 0.80 : 1 (1980-81) as the maximum and with an average of 0.48 : 1. Thus the picture in this company also fell in line with the general trend in other sample companies under study.

Long-term Borrowings to Working Capital Ratio:

Normally long term sources of borrowed capital for the corporate sector are bonds and debentures, borrowings from financial institutions such as Industrial Finance Corporation, Industrial Development Bank of India, Industrial Credit & Industrial Corporation and the like, borrowings from Bank etc. Keeping with the trends of the general policy of financing public sector undertakings in India till early eighties, in the case of state owned public sector undertakings also there has been hardly any issue of bonds and debentures. In the cases of state owned and state controlled public sector undertakings the sources of long term borrowings have been mainly the nationalised sector of the
Table - 54: Showing Statement the Role of Long Term Debt for Financing Working Capital in Some Selected Companies Under the Ownership and Control of the State Government Undertakings Over a Period Between 1980-81 to 1989-90

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<td>0.56:1</td>
<td>0.57:1</td>
<td>0.49:1</td>
<td>0.56:1</td>
<td>0.51:1</td>
<td>0.50:1</td>
<td>0.58:1</td>
<td>0.11:1</td>
<td>0.01:1</td>
<td>0.21:1</td>
<td>0.41:1</td>
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<tr>
<td>The West Dinajpur Spinning Mills Ltd.</td>
<td>0.09:1</td>
<td>0.56:1</td>
<td>0.71:1</td>
<td>1.23:1</td>
<td>1.31:1</td>
<td>0.78:1</td>
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<tr>
<td>West Bengal Electronics Industry Development Corporation Ltd.</td>
<td>1.10:1</td>
<td>0.04:1</td>
<td>0.14:1</td>
<td>0.28:1</td>
<td>0.44:1</td>
<td>0.46:1</td>
<td>0.33:1</td>
<td>0.33:1</td>
<td>0.40:1</td>
<td>0.31:1</td>
<td>0.38:1</td>
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</table>

Source: Annual Report of the Companies. Results Computed
Banks and the financial institution such as Industrial Finance Corporation of India, Industrial Development Bank of India, Industrial Reconstruction Bank of India, Power Finance Corporation Ltd. and the like. Analysis further reveals that among the different categories of loans it is the unsecured loan from the State government which dominate the scene.

In Table 54 of this study, an attempt has been made to project the use of long term sources for the financing of working capital in the state owned and state controlled public sector undertakings in West Bengal. This has been accomplished with reference to the position that obtained in the sample companies under study.

The Durgapur Project Ltd.:

In this company the use of long term borrowings for financing working capital fluctuated between 0.01:1 (1988-89) as the minimum and 0.58:1 (1986-87) as the maximum with an average of 0.41 : 1 over the period under study.

The Durgapur Chemicals Ltd.:

In this company the use of long term borrowings for financing working capital fluctuated between 2.59:1 (1980-81) as the minimum and 10.88 : 1 (1989-90) as the maximum and with an average of 6.57:1 over the period under study.
The West Dinajpur Spinning Mills Ltd.:  

In this company the use of long term borrowings for financing working capital varied between 0.09:1 (1985-86) as the minimum and 1.31:1 (1989-90) as the maximum and with an average of 0.78:1 over the period under study. It indicates that the company had more than 78% of its finance for working capital out of long term borrowings.

The Kalyani Spinning Mills Ltd.:  

In this company the use of long term borrowings for financing working capital varied between 5.83:1 (1980-81) as the minimum and 22.16:1 (1985-86) as the maximum and with an average of 14.3:1 over the period under study.

The West Bengal Electronics Industry Development Corporation Ltd.:  

In this company long term borrowings to working capital ratio had been in the range between 0.04:1 (1981-82) as the minimum and 1.10:1 (1980-81) as the maximum with an average of 0.38:1 over the period under study. It indicates that the company had more than 38% of its finance for working capital out of long term borrowings. From these details the obvious conclusion
becomes that in the matter of provision of working capital funds of the selected companies under study, the share of long term borrowed capital had been quite significant.

Short Term Sources to Working Capital Ratio:

The short term sources of working capital finance in the corporate sector generally comprise trade credit, public deposits, bank overdraft, cash credit, and other short term sources such as advance from customers etc. Short term sources as already stated have the advantage that it is flexible besides being relatively cheaper. And it has the disadvantage that it involves high degree of risk. Nevertheless, corporate undertakings are to use short term sources as the entire amount of working capital finance cannot be provided from long term sources such as equity and borrowed capital. In the case of the companies selected for the study the sources of short term funds for working capital purposes had been mainly the supply from creditors. Advance from customers, Security Deposits, Interest accrued but not due etc. Interestingly cash credit had been conspicuous by its absence as a source of short term finance in the public sector undertakings in West Bengal which are under study.

In the circumstances, in Tables 55 and 56 of the present study an attempt has been made to project the ratio of Sundry Creditors/Working Capital and the ratio of other creditors to working capital in the sample companies in order to
Table - 55 : Showing Statement Sundry Creditors in Financing Working Capital in Some Selected Sample Companies Under the Ownership and Control of the State Government Undertakings Over a Period Between 1980-81 to 1989-90

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<tr>
<td>The Durgapur Project Ltd.</td>
<td>0.24:1</td>
<td>0.23:1</td>
<td>0.20:1</td>
<td>0.18:1</td>
<td>0.17:1</td>
<td>0.70:1</td>
<td>0.27:1</td>
<td>0.28:1</td>
<td>0.33:1</td>
<td>0.34:1</td>
<td>0.25:1</td>
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<tr>
<td>The Durgapur Chemicals Ltd.</td>
<td>1.01:1</td>
<td>1.16:1</td>
<td>1.25:1</td>
<td>1.38:1</td>
<td>1.95:1</td>
<td>2.17:1</td>
<td>3.42:1</td>
<td>1.06:1</td>
<td>1.52:1</td>
<td>1.50:1</td>
<td>1.64:1</td>
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<tr>
<td>The West Dinajpur Spinning Mills Ltd.</td>
<td>0.50:1</td>
<td>0.98:1</td>
<td>1.24:1</td>
<td>1.93:1</td>
<td>2.80:1</td>
<td>3.08:1</td>
<td>2.75:1</td>
<td>2.39:1</td>
<td>1.01:1</td>
<td>0.44:1</td>
<td>1.71:1</td>
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<tr>
<td>The Kalyani Spinning Mills Ltd.</td>
<td>0.43:1</td>
<td>0.42:1</td>
<td>0.30:1</td>
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<td>0.11:1</td>
<td>0.06:1</td>
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<td>0.03:1</td>
<td>0.16:1</td>
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<tr>
<td>West Bengal Electronics Industry Development Corporation Ltd.</td>
<td>0.43:1</td>
<td>0.42:1</td>
<td>0.30:1</td>
<td>0.18:1</td>
<td>0.11:1</td>
<td>0.06:1</td>
<td>0.04:1</td>
<td>0.02:1</td>
<td>0.03:1</td>
<td>0.03:1</td>
<td>0.16:1</td>
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Source : Published Annual Report of the Companies Results computed
highlight the role that other creditors as a source of working capital finance in the public sector undertakings under the ownership and control of the State of West Bengal.

**Sundry Creditors/Working Capital Ratio**

**The Durgapur Project Ltd.:**

For working capital purposes sundry creditors are a spontaneous sources. It will be observed from Table 55 of the present study have been prepared to project the use of short term creditors by the selected companies for financing their working capital requirements. That short term creditor to working capital ratio in this company had been in the range between 0.17 : 1 (1984-85) as the minimum and 0.70 : 1 (1985-86) as the maximum with an average of 0.25 : 1 over the period under study.

**The Durgapur Chemicals Ltd.:**

In this company short term credit to working capital had been in the range between 1.01 : 1 (1980-81) as the minimum and 3.42 : 1 (1986-87) as the maximum with an average of 1.64 : 1 over the period under study.

**The West Dinajpur Spinning Mills Ltd.:**

In this company short term creditor sources
to working capital fluctuated between 0.15 : 1 (1985-86) as the minimum and 0.41 : 1 (1989-90) as the maximum with an average of 0.28 : 1 over the period under study.

The Kalyani Spinning Mills Ltd.:

In this company the ratio of short term credit to working capital ratio varied between 0.44 : 1 (1989-90) as the minimum and 3.08 : 1 (1985-86) as the maximum with an average of 1.71 : 1 over the period under study.

The West Bengal Electronics Industries Development Corporation Ltd.:

In this company the ratio of short term credit to working capital had been in the range between 0.02 : 1 (1987-88) as the minimum and 0.43 : 1 (1980-81) as the maximum with an average of 0.16 : 1 over the period under study.

Other Short Term Credits to Working Capital Ratio:

In Table 56 of the study an attempt has been made to project the ratio of other short term credit to working capital in the selected sample companies when other short term creditors include, advance from customers, advance from contractors, security deposit and interest due but not paid.
Table 56: Showing Statement Short Term Sources for Financing Working Capital in Some
Selected Companies Under the Ownership and Control of the State Government
Undertakings Over a Period Between 1980-81 to 1989-90

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<tr>
<td>The Durgapur Project Ltd.</td>
<td>0.16:1</td>
<td>0.17:1</td>
<td>0.16:1</td>
<td>0.24:1</td>
<td>0.27:1</td>
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<td>0.27:1</td>
<td>0.26:1</td>
<td>0.32:1</td>
<td>0.44:1</td>
<td>0.40:1</td>
<td>0.65:1</td>
<td>0.80:1</td>
<td>0.82:1</td>
<td>0.72:1</td>
<td>0.49:1</td>
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<td>The West Dinajpur Spinning Mills Ltd.</td>
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<td>0.15:1</td>
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<td>0.31:1</td>
<td>0.32:1</td>
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<tr>
<td>The Kalyani Spinning Mills Ltd.</td>
<td>0.33:1</td>
<td>0.63:1</td>
<td>0.66:1</td>
<td>0.74:1</td>
<td>1.07:1</td>
<td>1.05:1</td>
<td>0.94:1</td>
<td>0.58:1</td>
<td>0.43:1</td>
<td>0.32:1</td>
<td>0.68:1</td>
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<tr>
<td>West Bengal Electronics Industry Development Corporation Ltd.</td>
<td>0.13:1</td>
<td>0.16:1</td>
<td>0.13:1</td>
<td>0.13:1</td>
<td>0.14:1</td>
<td>0.10:1</td>
<td>0.16:1</td>
<td>0.18:1</td>
<td>0.15:1</td>
<td>0.25:1</td>
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Source: Published Annual Report of the Companies Results Computed
The Durgapur Project Ltd. :

It will be observed from the Table that the other short term credit to working capital ratio in the Durgapur Project Ltd. fluctuated between 0.16 : 1 (1980-81) as the minimum and 0.34 : 1 (1989-90) as the maximum with an average of 0.22 : 1 over the period under study.

The Durgapur Chemicals Ltd. :

In this company the other short term credit to working capital ratio varied between 0.21 : 1 (1980-81) as the minimum and 0.82 : 1 (1988-89) as the maximum with an average of 0.49 : 1 over the period under study.

The West Dinajpur Spinning Mills Ltd. :

In this company the other short term credit to working capital ratio fluctuated between 0.15 : 1 (1985-86) as the minimum and 0.41 : 1 (1989-90) as the maximum with an average of 0.28 : 1 over the period under analysis.

The Kalyani Spinning Mills Ltd. :

In this company the ratio of other short term credit to working capital varied between 0.32 : 1 (1989-90) as the minimum and 1.07 : 1 (84-85) as the maximum with an average of 0.68 : 1 over the period under study.
The West Bengal Electronics Industries Development Corporation Ltd.:  

In this company the ratio of other short term credit to working capital had been in the range between 0.10 : 1 (1985-86) as the minimum and 0.25 : 1 (1989-90) as the maximum with an average of 0.15 : 1 over the period under analysis. On the basis of the analysis in Table 53 and 54 of the study, one will be tempted to conclude that the state owned public sector undertakings in West Bengal mainly relied on the long term sources viz, equity and long term borrowings for financing their working capital. But it has to be borne in mind that the aforesaid position could actually prevail in the companies under study provided these companies could operate at least at break even. Once they suffer the loss and the losses are brought into picture, there becomes a total metamorphosis in the position. This goes to explain why the liquidity position of the some selected sample companies could remain depressed as shown in Table 51 and 52 of the study despite the fact that apparently public sector undertakings under the ownership and control of the government of West Bengal had bulk of their working capital finance from the long term sources viz, equity and or borrowings.