CHAPTER :- 1

CONCEPTUAL FRAMEWORK OF WORKING CAPITAL.

1.1 INTRODUCTION.
1.2 CONCEPT OF WORKING CAPITAL MANAGEMENT.
   1.2.1 CURRENT ASSETS.
   1.2.2 CURRENT LIABILITIES.
   1.2.3 CIRCULATING CAPITAL.
1.3 WORKING CAPITAL MEANING.
1.4 CIRCULATION OF WORKING CAPITAL.
1.5 OPERATING CYCLE.
1.6 DURATION OF THE OPERATING CYCLE.
1.7 OBJECTIVES OF WORKING CAPITAL.
1.8 TYPES OF WORKING CAPITAL.
   1.8.1 CLASSIFICATION ON THE BASIS OF CONCEPT.
   1.8.2 CLASSIFICATION ON THE BASIS OF FINANCIAL STATEMENT.
   1.8.3 CLASSIFICATION ON THE BASIS OF VARIABILITY.
1.9 ADEQUATE WORKING CAPITAL.
1.10 INADEQUATE WORKING CAPITAL AND EXCESS OF WORKING.
   1.10.1 INADEQUATE WORKING CAPITAL.
   1.10.2 EXCESS WORKING CAPITAL.
1.11 PRINCIPLES OF WORKING CAPITAL MANAGEMENT.
   1.11.1 PRINCIPLE OF RISK VARIATION.
1.11.2 PRINCIPLE OF COST OF CAPITAL.
1.11.3 PRINCIPLE OF EQUITY POSITION.
1.11.4 PRINCIPLE OF MATURITY OF PAYMENT.
1.11.5 PRINCIPLE OF CIRCULATION.
1.11.6 PRINCIPLE OF LIQUIDITY.
1.11.7 PRINCIPLE OF ADEQUACY.

1.12 FACTOR AFFECTING THE WORKING CAPITAL NEEDS.
1.12.1 NATURE OF BUSINESS.
1.12.2 SIZE OF BUSINESS.
1.12.3 MANUFACTURING CYCLE.
1.12.4 PRODUCTION POLICY.
1.12.5 WORKING CAPITAL CYCLE.
1.12.6 SEASONAL VARIATIONS.
1.12.7 CREDIT TERMS.
1.12.8 RATE OF STOCK TURNOVER.
1.12.9 RATE OF GROWTH OF BUSINESS.
1.12.10 EARNING CAPACITY AND DIVIDEND POLICY.
1.12.11 PRICE LEVEL CHANGES.
1.12.12 BUSINESS FLUCTUATIONS.
1.12.13 CONDITIONS OF SUPPLY.
1.12.14 CREDIT POLICY OF ENTERPRISES.
1.12.15 GROWTH AND EXPANSION.
1.12.16 VOLUME OF SALE.
1.12.17 LIQUIDITY AND PROFITABILITY.
1.12.18 MANAGEMENT ABILITY.
1.12.19 CASH REQUIREMENTS.
1.12.20 TIME.
1.12.21 TERMS OF PURCHASE AND SALE.
1.12.22 INVENTORY TURNOVER.
1.12.23 RECEIVABLE TURNOVER.
1.12.24 BUSINESS CYCLE.
1.12.25 VARIATION IN SALES.
1.12.26 PRODUCTION CYCLE.
1.12.27 PROFIT PLANNING AND CONTROL.
1.12.28 ACTIVITIES OF THE FIRMS.
1.12.29 TURNOVER OF CIRCULATING CAPITAL.
1.12.30 INHERENT HAZARDS AND CONTINGENCIES.
1.12.31 REPAYMENT ABILITY.
1.12.32 AVAILABILITY OF CREDIT.
1.12.33 OPERATION AND FINANCIAL EFFICIENCY.
1.12.34 DIVIDEND POLICY.
1.12.35 VALUE OF CURRENT ASSETS.
1.12.36 GESTATION PERIOD.
1.12.37 OTHER FACTORS.

1.13 SOURCES OF WORKING CAPITAL.
1.13.1 LONG TERM SOURCES, FIXED WORKING CAPITAL, PERMANENT SOURCES.
1.13.2 SHORT TERM SOURCES.

1.14 STRUCTURE OF WORKING CAPITAL.
1.14.1 CURRENT ASSETS.
1.14.2 CURRENT LIABILITIES.

1.15 IMPORTANCE OF WORKING CAPITAL MANAGEMENT.

1.16 CONCLUSION.

REFERENCES
CHAPTER :- 1
CONCEPTUAL FRAMEWORK OF WORKING CAPITAL.

1.1 INTRODUCTION :-

Any person cannot ignore the necessity of funds in a business unit either a retail shop or a large manufacturing unit. Money is the only common factor in all units. Thus money management is must that is commonly known as financial management. Proper management of invested funds in a business results in effective financial management. Each and every business unit needs funds.

The uses of funds of a concern can be divided into two parts namely long-term funds and short-term funds. The long–term investment may be termed as ‘fixed investment.’ A major part of the long-term funds is invested in the fixed assets. These fixed assets are retained in the business to earn profits during the life of the fixed assets. To run the business operations short–term assets are also required.

A manufacturing concern is sure to collapse without an adequate supply of working capital. Working capital is just like the heart of business. Working capital management is a significant in financial management due to the fact that is plays a pivot role in keeping the wheels of a business enterprise running. Working capital management is concerned with short-term financial decisions.

Working capital is work as Blood in business. So, any business firm cannot work without working capital. Inadequate working capital means shortage of inputs, whereas excess of it leads to extra cost. So the
quantum of working capital in every business firm should be neither more nor less than what is actually required. The management has to see that funds invested as working capital in their organization earn return at least as much as they would have earned return if it invested anywhere else. At the time of increasing capital costs and scare funds, the area of working capital management assumes added importance as it deeply influences a firm's liquidity and profitability. A notable feature of utilization of funds is that they are of recurring nature. Therefore, efficient working capital management requires a proper balance between generation and utilization of these funds without which either shortage of funds will cause obstruction in the smoother functioning of the organization or excess funds will prevent the firm from conducting its business efficiently. So the main objective of working capital management is to arrange the needed funds on the right time from the right source and for the right period, so that a trade of between liquidity and profitability may be achieved.

A firm invests a part of its permanent capital in fixed assets and keeps a part of it for working capital i.e. for meeting the day to day requirements. We will hardly find a firm which does not require any amount of working capital for its operations the requirement of working capital varies from firm to firm depending upon the nature of business, production policy, market conditions Seasonality of operations, condition of supply etc. Working capital is the most vital ingredient of a business. Working capital management if carried out effectively, efficiently and consistently will assure the health of an organization.
1.2 CONCEPT OF WORKING CAPITAL MANAGEMENT :-

There are two concepts of working capital quantitative and qualitative. Some people also define the two concepts as gross concept and net concept. According to quantitative concept, the amount of working capital refers to ‘Total of current assets’. What we call current assets? Smith\(^1\) called, ‘Circulating capital’. Current assets are considered to be gross working capital in this concept.

The qualitative concept gives an idea regarding source of financing capital. According to qualitative concept the amount of working capital refers to “Excess of current assets over current liabilities.”\(^2\) L.J. Guthmann defined working capital as “The portion of a firm’s current assets which are financed from long–term funds.”\(^3\)

The excess of current assets over current liabilities is termed as ‘Net working capital’. In this concept “Net working capital” represents the amount of current assets which would remain if all current liabilities were paid. Both the concepts of working capital have their own points of importance. “If the objectives is to measure the size and extent to which current assets are being used, ‘Gross concept’ is useful; whereas in evaluating the liquidity position of an undertaking ‘Net concept’ becomes pertinent and preferable.

It is necessary to understand the meaning of current assets and current liabilities for learning the meaning of working capital, which is explained below.
1.2.1 CURRENT ASSETS :-

It is rightly observed that “Current assets have a short life span. These types of assets are engaged in current operation of a business and normally used for short term operations of the firm during an accounting period i.e. within twelve months. The two important characteristics of such assets are, (1) short life span, and (2) swift transformation into other form of assets. Cash balance may be held idle for a week or two, account receivable may have a life span of 30 to 60 days, and inventories may be held for 30 to 100 days.”

Fitzgerald defined current assets as, “cash and other assets which are expected to be converted into cash in the ordinary course of business within one year or within such longer period as constitutes the normal operating cycle of a business.”

1.2.2 CURRENT LIABILITIES :-

The firm creates a Current Liability towards Creditors’ (sellers) from whom it has purchased raw materials on credit. This liability is also known as accounts payable and shown in the balance sheet till the payment has been made to the Creditors”.

The claims or obligations which are normally expected to mature for payment within an accounting cycle are known as current liabilities. These can be defined as “those liabilities where liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current assets, or the creation of other current liabilities.”
1.2.3 CIRCULATING CAPITAL :-

Working capital is also known as ‘circulating capital or current capital.’ “The use of the term circulating capital instead of working capital indicates that its flow is circular in nature.”

1.3 WORKING CAPITAL MEANING :-

Working capital, like many other financial and accounting terms have been used by different people in different senses. One school of thought believes as all capital resources available to a business organization from shareholders, bondholders and Creditors”’ “Works” up in the business activities to generate revenues and facilitate future expansion and growth, they are to be considered as ‘Working capital’. Another school of thought link, ‘Working capital’ with current assets and current liabilities. According to them, the excess of current assets over current liabilities is to be rightly considered as the ‘working capital’ of a business organization.

Working Capital consists of that portion of the assets of a business, which are used, in current operations. It includes receivables, inventories or raw materials, stores, work-in-progress and finished goods, merchandise, bill receivable and cash.

These types of assets are normally temporary in nature. In accounting concept of working capital it is the difference between inflow and outflow of funds i.e. sources and uses of funds, (i.e. net cash inflow). In other words, working capital is the excess of current assets over current liabilities.
Working capital management is concerned with problem that arises in attempting to manage the current liabilities and the interrelationship exists between them. Management of short-term asset and short term financing is referring to working capital management and current asset management. The goal of working capital management is to manage a current asset in such a manner so that the satisfactory level should be maintained.

Working capital is defined as the excess of current assets over current liabilities; Current assets are those assets which will be converted in to cash within the current accounting period or within the next year as a result of the ordinary operations of the business. They are cash or near cash resources. These include:

- Cash and Bank balances
- Receivables
- Inventory
  - Raw materials, Stores and spares
  - Work in progress
  - Finish Goods
- prepaid expenses
- Short-term advances
- Temporary investments

The value represent by these assets circulates among several items. Cash is used to buy raw-materials, to pay wages and to meet other manufacturing expenses. Finished goods are produced. These are held as
inventories. When these are sold, accounts receivables are created. The collections of accounts receivable brings cash into the firm. The cycle stats again. This is show in.

Current liabilities are the debt of the firms that have to be paid during the current accounting period or within a year. These include:

- Creditors’ for goods purchased.
- Outstanding expense i.e. expenses due but not paid.
- Short-term borrowing.
- Advances received against sales.
- Taxes and dividends payable.
- Other liabilities maturing within a year.

Working capital is also known as circulating capital, fluctuating capital and resolving capital. The magnitude and composition keep on changing continuously in the course of business.

"Working capital as represented by excess of current assets over current liabilities and identifying the relatively liquid portion of the total enterprise capital which constitutes a margin for meeting obligation within the ordinary operating cycle of the business."

"The sum of the current asset is the working capital" J.S. Mill defines the gross concept. "Whenever working capital is maintained it brings to mind current assets and current liabilities with general understanding that working capital is the difference between the two."
1.4 CIRCULATION OF WORKING CAPITAL :-

At one given time both the current assets and current liabilities exist in the business. The current assets and current liabilities are flowing round in a business like an electric current. However, “The working capital plays the same role in the business as the role of heart in human body. Working capital funds are generated and these funds are circulated in the business. As and when this circulation stops, the business becomes lifeless. It is because of this reason that he working capital is known as the circulating capital as it circulates in the business just like blood in the human body.”

Figure No.1 depicting ‘Working Capital Cycle’ makes it clear that the amount of cash is obtained mainly from issue of shares, borrowing and operations. Cash funds are used to purchase fixed assets, raw materials and used to pay to Creditors”. The raw materials are processed; wages and overhead expenses are paid which in result produce finished goods for sale.
The sale of goods may be for cash or credit. In the former case, cash is directly received while in later case cash is collected from debtors’. Funds are also generated from operation and sale of fixed assets. A portion of profit is used for payment of interest, tax and dividends while remaining is retained in the business. This cycle continues throughout the life of the business firm.
1.5 OPERATING CYCLE :-

The duration of time required to complete the following sequence of events, in case of manufacturing firm, is called the operating cycle:

- Conversion of cash into raw materials.
- Conversion of raw materials into work-in-progress.
- Conversion of work in process into finished goods.
- Conversion of finished goods into debtors’ and bills receivables through sales.
- Conversion of debtors’ and bills receivables into cash.

The length of cycle will depend on the nature of business. Non-manufacturing concerns, service concerns and financial concerns will not have raw material and work-in-process so their cycle will be shorter. Financial Concerns have a shortest operating cycle.
1.6 DURATION OF THE OPERATING CYCLE :-

The operating cycle of a concern begins with the acquisition of raw materials and stock at the point of collection of receivables. It may be divided into the following stages: -

- Raw material and store stage
- Work-in-Progress stage
- Finished goods inventory storage period stage
- Receivable stage.
The duration of the operating cycle is equal to the sum of the duration of each of these stages less the credit period allowed by the suppliers of the firm. In symbols,

\[ O = R + W + F + D - C \]

Where,

\( O \) = duration of operating cycle.
\( R \) = raw material storage period.
\( W \) = work-in-process period.
\( F \) = finished goods storage period.
\( D \) = debtors’ collection period, and
\( C \) = Creditors’ payment period.

The components of the operating cycle may be calculated as follows:

\[ R = \dfrac{Average \ of \ raw \ material \ and \ stores}{dxAverage \ raw \ material \ and \ stores \ consumption \ per \ day} \]

\[ W = \dfrac{Average \ work-in-process \ inventory}{Average \ cost \ of \ production \ per \ day} \]

\[ F = \dfrac{Average \ finished \ goods \ inventory}{Average \ cost \ of \ goods \ sold \ per \ day \ per \ day} \]
CONCEPTUAL FRAMEWORK OF WORKING CAPITAL MANAGEMENT.

\[ D = \frac{\text{Average book debts}}{\text{Average credit sales per day}} \]

\[ C = \frac{\text{Average trade Creditors’}}{\text{Average credit purchase per day}} \]

1.7 OBJECTIVES OF WORKING CAPITAL :-

Working capital is the heart of business. If it becomes week the business is unlikely to proper and survive later it will topple down. It is an index of the solvency of a concern. Its proper calculation provides to the business. The right amount at cash to maintained, the business can avail of the cash discount facilities offered to it by supplies, moreover. It also enhances so that the business can see itself go through periods of crisis, the morale of the business is high and efficiency is also at its highest pitch.

The need of working capital cannot be ignored as well as over emphasized. Working capital is a need of every business unit. The need of working capital comes into existence due to the time gap between production and realization of cash from sales and it is known as operating cycle. There are time gap between purchase of inventory items and production, production and sales and sales it’s conversion into cash. Thus, working capital is needed to fulfill the following objects:
1. For the purchase of inventories, components and spares.
2. To overcome day-to-day expenses and overheads cost such as fuel, power or electricity, office expenses.
3. To pay wages and salaries to the employees.
4. To provide the credit facilities to the customers.
5. To meet the selling expenses i.e. packing, advertising, etc.
6. For maintaining sufficient stock of raw material, work-in-process, stores and spares and finished goods.
7. By optimizing the investment in current assets and by reducing the level of current liabilities, the company can reduce the looking up of funds in working capital thereby.
8. It can improve the return on capital employed in the business.
9. The second important objective of working capital is that the Company should always be in a position to meet its current obligations which should properly be supported by the current assets available with the firm. But maintaining excess funds in working capital means looking of funds without return.
10. The firm should manage its current assets in such a ways that the marginal return on investment in these assets is not less than the cost of capital employed to finance the current assets.

These are the objects, which can be fulfilled by ready cash i.e. working capital. The amount of working capital defers with change in circumstances in the same enterprise as well as it defers from firm to firm. For determining the amount of working capital in a business. One has to study the business under varying circumstances such as a newly started business a growing business and a matured business. A newly
invented business requires more working capital to attain the initial expenses like promotion, production, advertisement etc. at the same time the amount of these preliminary expenses depends on the size and type of business. The amount of needed working capital increases with increasing growth and expansion of business till it attains maturity. At maturity the amount of working capital needed is called normal working capital. There are many other factors, which influence the need of working capital in a business.

1.8 TYPES OF WORKING CAPITAL :-

Working capital can be classified either on the basis of its concept or on the requirements for short-term finance. According to the former view, it may be gross working capital or net working capital. Gross working capital is represented by the total current assets the amount of current liabilities. However, the modern view is that working capital and net working capital are one and the same.

The quantitative concept of Working Capital is known as gross working capital while that under qualitative concept is known as net working capital.

Working capital can be classified in various ways. The important classifications are as given below:
1.8.1 CLASSIFICATION ON THE BASIS OF CONCEPT :-

1.8.1.1 GROSS WORKING CAPITAL :-
1.8.1.2 NET WORKING CAPITAL :-
1.8.1.3 WORKING CAPITAL DEFICIT :-

1.8.2 CLASSIFICATION ON THE BASIS OF FINANCIAL STATEMENT :-

1.8.2.1 BALANCE SHEET :-
1.8.2.2 PROFIT & LOSS ACCOUNT / CASH WORKING CAPITAL :-

1.8.3 CLASSIFICATION ON THE BASIS OF VARIABILITY :-

1.8.3.1 PERMANENT WORKING CAPITAL :-
1.8.3.2 VARIABLE WORKING CAPITAL :-
1.8.3.3 TEMPORARY WORKING CAPITAL :-

1.8.1 CLASSIFICATION ON THE BASIS OF CONCEPT :-

There are two concept of working capital viz., quantitative and qualitative. The quantitative concept takes into account as the current assets while the qualitative concept takes into account the excess of current assets over current liabilities. Deficit of working capital exists where the amount of current liabilities exceeds the amount of current assets. The above can be summarized as follows:
1.8.1.1 GROSS WORKING CAPITAL :-

"Gross working capital = Total current assets"

This concept is also known as quantitative concept. It takes current assets i.e. cash, accounts receivables, merchandize, debtors’ etc. into account. When the organization considers long-term funds, this concept is significant.
1.8.1.2 NET WORKING CAPITAL :-

"Net working capital = Excess of current assets over current liabilities"

This concept is also known as qualitative concept. According to this concept, working capital is the excess of current assets over current liabilities. This concept shows how much amount is left for operating activities. For determining the financial position (i.e. liquidity) this concept is significant.
1.8.1.3 WORKING CAPITAL DEFICIT :-

"Working capital deficit = Excess of current liabilities over current assets."

Excess of current liabilities over current assets is deficit working capital. Such a situation is not absolutely theoretical and occurs when a firm is nearly a crisis of some magnitude.

1.8.2 CLASSIFICATION ON THE BASIS OF FINANCIAL STATEMENT :-

The information of working capital can be collected from Balance Sheet or Profit and Loss Account; as such the working capital may be classified as follows:

1.8.2.1 BALANCE SHEET :-

When the information regarding the working capital is collected from the balance sheet (i.e. the items appearing in balance sheet), then this type of working capital is known as balance sheet working capital.

The basis can now again classified as:-

- Gross Working Capital:-
- Net working Capital:-
- Deficit Working Capital:-
1.8.2.2 PROFIT & LOSS ACCOUNT / CASH WORKING CAPITAL :-

Cash working capital arises when the items regarding the working capital are collected from the profit and loss account i.e. the items appearing in P&L A/c. It shows the real flow of money and values at a particular time and is considered to be then more realistic approach and having great significance to working capital management in recent years as it shows the adequacy of cash flow in business. It is based on operating cycle concept.

The duration of time required to complete the different events like conversion of cash into raw materials, raw material into work-in-progress, work-in-progress into finished goods, finished goods to debtors’ and bill receivable through sales and conversion of bill receivable to cash etc. in case of manufacturing firm.

1.8.3 CLASSIFICATION ON THE BASIS OF VARIABILITY :-

Gross Working Capital can be divided in two categories viz., (i) permanent or fixed working capital, and (ii) Temporary, Seasonal or variable working capital. Such type of classification is very important for hedging decisions.

1.8.3.1 PERMANENT WORKING CAPITAL :-

The working capital which is permanent in nature i.e. which cannot be varied due to variation in sales. It is the minimum level of current
assets kept by the organization required always for business operation even if there is fluctuation in sales.

Normally it consists of low level of inventory cash, bill receivable, and material in process, finished goods. These can be obtained any day of the year because it is permanent in nature. Amount of such investment is called as Permanent Working Capital. Permanent Working Capital is also known as fixed or regulating Working Capital. This amount varies year-to-year depending upon the growth and stage of business cycle in which it operates.

 Characteristics:-

➢ Classified on the basis of time factor
➢ Always remain in process.
➢ Size increases according to growth of enterprise.
➢ Suited for business, which is the same for all the yearlong.
➢ Constantly changes from one asset to another.

1.8.3.2 VARIABLE WORKING CAPITAL :-

It is required during the most active seasons of the year. It is most suited to the business, which is seasonal and cyclical in nature. It represents as additional asset required for normal functioning of business in favorable seasons. It changes according to variation in sales.
1.8.3.3 TEMPORARY WORKING CAPITAL :-

Total Current Assets - Permanent Current Assets. It changes according to change in operational activity. This type of working capital is also known as Temporary, Seasonal or Special Working Capital.

The Permanent is constant and temporary is fluctuating according to seasonal demand.
"The working capital is also known as circulating capital. The use of the term circulating capital instead of working capital points that flow is circular in nature." The current assets and current liabilities are flowing round in a business like current in electric circuit, water in a river and blood in body. The funds of a manufacturing firm are obtained from various sources such as issue of shares and debentures, long term and short-term borrowings and ploughed back of the earning of business. A major part of the funds is used to purchase fixed assets and the remaining part is utilized for day to day operations i.e. to pay Creditors’ for raw material purchased, to pay wages and overheads expenses for production of finished goods and on sales, book debts are generated from which one has to pay interest, taxes and dividends etc. and the remaining part is ploughed into the business. This cycle goes on constantly throughout the life of a firm.

The term circulating capital is frequently used to denote those assets, which are changed relatively and rapidly from one form to another. Working capital is essentially a circulating capital.

Working capital funds are generated and these funds are circulated in the body of a business. As and when this circulation stops, the business gets weaker and drops down dead. It is because of the reason that the working capital is known as the circulating capital as it circulates in the business as the Wood in the human body.
1.9 ADEQUATE WORKING CAPITAL :-

Circulations of blood are essential in the human body for maintaining life similarly working capital is the lifeblood of a business. It is very essential to maintain the smooth running of a business. Even a fully equipped manufacturing firm is sure to collapse without an adequate supply of raw material to process, cash to meet the wage bill, the capacity to wait for the market for its finished product and the ability to grant credit to its customers.

A study of working capital is of major importance of internal and external analysis because of its close relationship to current day to day operation of business. Inadequacy or mismanagement of working capital is the leading cause of business failure.

The importance of adequacy of working capital can hardly be over emphasized. Many other business failure takes place due to lack of working capital. Hence Working Capital is considered as the lifeblood and the controlling nerve centre of a business. Inadequate working capital is a business ailment. Therefore, a firm has to maintain adequate working capital. It is as important as blood circulation in our body to maintain life and flow of funds is very necessary to maintain business.

Adequacy of working capital is very important in a way that the working capital represents near about half of all the value of assets in balance sheet. It is necessary to maintain a proper balance between current assets and liabilities otherwise it may affect an enterprise badly and even become the cause of liquidation.
Working capital should be sufficient to enable a company to conduct its business on the most economical basis and without financial stringency and to meet emergencies and losses without danger of financial disasters.

Adequacy of working capital is also necessary to protect it from shrinkage in the value of current asset. It also makes it possible to take advantage of cash discount and also helps to determine credit terms to customer. It enables a company to operate its business more efficiently because there would be delay due to credit difficulties in obtaining materials services and supplies.

It should be noted here that excess working capital especially in the form of cash and marketable securities may be as unfavorable as inadequacy of working capital because of large volume of funds not being used productively.

Idle funds involve a lower amount of income and often lead to investment in undesirable projects or in unnecessary plant facilities equipment. In fact, availability of excess working capital may lead to carelessness about cost and therefore to inefficiency in operations.

Mismanagement of working capital leads to adverse effects. Just like excess food in our body is very dangerous and little food leads to starvation. As a company the excess working capital leads to inflation and inadequate working capital leads to deflation.

It permits the carrying of inventories at a level that would enable a business to serve satisfactorily the needs of customers.
CONCEPTUAL FRAMEWORK OF WORKING CAPITAL MANAGEMENT.

- It enables a company to operate its business more efficiently because there is no delay in obtaining materials etc. because of credit difficulties.
- It enables a business to withstand periods of depression smoothly i.e. business run efficiently in adverse circumstances.
- It enables a company to extend credit to its customers.
- Increasing price may necessitate investment in inventories and fixed assets.
- There may be unwise dividend policy.
- The management is not in form to manage credit for further expansion.
- The current funds may be invested in non-current assets.
- The management is not in position to manage funds for meeting debentures on maturity and liabilities timely (as and when required).
- There may be operating losses.
- There may be decrease in profit and decrease in retained earnings.
- To protect the organization from the adverse effect from the shrinkage in current assets.
- It ensures to a greater extent the maintenance of company's credit standing and provides for such emergencies as floods strikes etc.

For smoother running of a business, an adequate amount of working capital is very essential. In its absence, fixed assets cannot gainfully be employed. The business should have enough cash to meet its
current obligations. To avoid interruption in production schedule and to maintain sales, a firm requires funds to finance inventories and receivables. The adequacy of cash and other current assets together with their efficient handling virtually determine the survival or demise lifeblood and the controlling nerve center of a business. Inadequate working capital is a business ailment.

If a business maintains an adequate amount of working capital it not only gets rid of the dangers of short working capital but also enjoys a good rating and receives cash discount on its payments. It can pass a period of depression without much difficulty.

1.10 INADEQUATE WORKING CAPITAL AND EXCESS OF WORKING :-

1.10.1 INADEQUATE WORKING CAPITAL :-

1.10.2 EXCESS WORKING CAPITAL :-

1.10.1 INADEQUATE WORKING CAPITAL :-

Deficiency or excess of nutrients causes deceptions. Inadequate working capital is dangerous sign for the existence of the firm. It should have neither redundant not short working capital. Both positions are bad for the firm. However, from the point of firms’ view, the inadequacy of working capital is more dangerous. Disadvantages of Excessive Working Capital
The need of adequate working capital can hardly be questioned. Just as food is necessary for a human being but too much of it may be as harmful as too little of it. In an enterprise, too little working capital means starvation and too much leads to inflation, which is certain to wreck the foundation of strength.

Inadequate working capital affects the firm's solvency adversely and excessive working capital affects the firm's profitability adversely. Inadequate working capital implies shortage of regular funds to carry on the normal business operation. A business may have inadequate working capital mainly because of the four reasons i.e. under investment in inventories, under investment in marketable securities, insufficient or under investment of receivables, shortage of liquid funds i.e. cash etc.

If a firm plans working capital requirement properly it may have at one time inadequate working capital and at another time excess working capital.

When working capital is inadequate, the company faces the following problems:

- The modernization of equipment and even routine repairs and maintenance facilities may be difficult to administer.
- A Company cannot afford to increase its cash sales and may have to restrict its activities to credit sales only.
- It is not possible for it to utilize production facilities fully for want of working capital.
A Company may not be able to take advantage of cash discount facilities.

The credit worthiness of the company is likely to be jeopardized because of lack of liquidity.

A Company may not be able to take advantage of profitable business opportunities.

A Company will not be able to pay its dividends because of the non availability of funds.

A Company may have to borrow funds at exorbitant rates of interest.

Its low liquidity may lead to low profitability in the same way as low profitability results in low liquidity.

Low liquidity would positively threaten the solvency of the business. A Company is considered illiquid when it is not able to pay its debts on maturity. Overall inefficiency in the organization may be the only outcome.

The excessive working capital may draw to speculative transactions.

Due to low rate of return on investments, the value of shares may also fall.

Irregularity or late payment in short term liabilities results in loss of reputation and also makes firm unable to get good credit facilities.

Regular supply of material cannot be maintained due to inadequate working capital. This affects the whole production cycle.

It cannot buy its requirements in bulk and cannot avail of discounts.
It cannot undertake profitable projects due to lack of working capital.

It becomes difficult to pay day to day expenses of firm’s operations and it creates inefficiency, increases cost and reduces the profits of the business.

The rate of return on investments also falls with the shortage of working capital.

1.10.2 EXCESS WORKING CAPITAL :-

Excess working capital especially in the form of cash and marketable securities may be unfavorable as inadequacy of working capital because of the large volumes of funds not being used productively. Idle funds involve a lower amount of income and often lead to investment to desirable projects or unnecessary plant facilities and equipment. In fact availability of excess working capital may lead to carelessness about and therefore to inefficiency of operation.

Credit is extended to undesirable cases and collection efforts get slackened, in the case of firm having more of the adequate working capital. On the one hand, people think that the management is conservative and that it does not want to expand the business and take full advantage of the funds at its disposal, on the other hand, unnecessary expansion takes place in these firms. It also includes the management into speculative activities. Sometimes directors exploit the situation of excess working capital for their personal benefit by giving liberal dividend which otherwise are not justified.
The situation of excess working capital also brings many disadvantages to the firm. Beside, the cost of holding it, which may demand on the source of financing working capital, excess working capital causes inefficiency in the management. It tempts the management to invest a large portion of funds in slow moving assets particularly inventories. Filling up of inventories out of proportion may itself create a situation of cash shortage.

Too much working capital is as dangerous as too little of it. Excessive working capital creates the following problems:

- A Company may enjoy high liquidity and at the same time, suffer from low profitability.
- A Company may be tempted to over trade and loss heavily.
- Excessive working capital may be as unfavorable as inadequacy of working capital if the large volumes of fund are not being used productively.
- A Company may keep very big inventories and tie its funds unnecessarily.
- There may be an imbalance between liquidity and profitability.
- High liquidity may induce a company to undertake greater production, which may not have a matching demand. It may find itself in an embarrassing position unless its marketing policies are properly adjusted to boost up the market for its goods.
- A Company may invest heavily in its fixed equipment that may not be justified by actual sales or production.

The immediate effects of excess working capital are:

- Low inventory
- Low working capital turnover
Higher cost of inventory
Higher bad debts losses

A business enterprise has excess working capital due to following reasons:

- Excess inventory
- Over investment in receivables.
- Over investment in marketable securities.
- Excess of liquid funds.

From the above discussion, we come to know that there should be proper management of working capital. Neither it should be inadequate nor should it be excess.

Thus, excess working capital is as dangerous as too little capital because of the portion of funds not being used gainfully. It tempts the management to invest funds in slow moving assets particularly inventories. It also causes carelessness about cost, and the result in inefficiency all around. Therefore working capital should be just adequate, not more or less, for the need of a business firm. Excess working capital should be avoided because it impairs a firm's profitability, as idle investment in current assets earns nothing. On the other hand, inadequate amount of working capital, particularly shortage of cash, can threaten the solvency of the firm if it fails to meet its current obligations.
1.11 PRINCIPLES OF WORKING CAPITAL MANAGEMENT :-

The following are the general principles of a sound working capital management policy.

1.11.1 PRINCIPLE OF RISK VARIATION :-

1.11.2 PRINCIPLE OF COST OF CAPITAL :-

1.11.3 PRINCIPLE OF EQUITY POSITION :-

1.11.4 PRINCIPLE OF MATURITY OF PAYMENT :-

1.11.5 PRINCIPLE OF CIRCULATION :-

1.11.6 PRINCIPLE OF LIQUIDITY :-

1.11.1 PRINCIPLE OF RISK VARIATION :-

The word "Risk" refers to the inability of a firm to maintain sufficient current asset to pay for its obligation. "If working capital varies relatively to fixed assets investment or sales, the amount to risk that a firm assumes also varies and the opportunity for gain or loss is increased."

This principle assumes that a relation exists between the degree of risk that a firm assumes and the rate of return i.e. the more risk assumed, the greater is the opportunity for gain or loss. As the level of working capital relative to sales decreases the degree of risk increases. When the degree of risk increases, the opportunity of gain or loss also increases. Thus, if the level of working capital goes up, the amount of risk goes up and vices versa. The opportunity for gain or loss is likewise adversely affected. Depending upon their attitudes, the management
changes the size of their working capital. A conservative management prefers to minimize risk by holding a higher level of working capital, while liberal management assumes greater risk by reducing this level. The goal of a management should; however be that level of working capital optimizes a firm’s rate of return. This level is the point at which

When a firm is unable to meet its obligations as and when they become due for payment is termed as a risk. When the current assets are made up of long term investment it increases liquidity, reduces dependence on short-term borrowings, reduces risk and thereby decreases the opportunity for gain and loss. On their hand if it is made up of short term barrowings, reduces liquidity, increases the dependence increases risk and profitability. It means, there is a definite inverse relationship between the degree of risk and profitability. A conservative management prefers minimum risk with less profitability while a liberal management goes with high degree risk and wants high profit. However, the goal of the management should be to establish a suitable tradeoff between profitability and risk. The various working capital policies indicating the relationship between current assets and sales are depicted back.

1.11.2 PRINCIPLE OF COST OF CAPITAL :-

The sources of working capital have different cost with changing degree of risk involved. A sound working capital management should always try to achieve a proper balance between cost and risk. Generally lower the risk higher is the cost and higher the risk lower is the cost.
The type of capital used to finance working capital directly affects the amount of risk that a firm assumes as well as the opportunity for gain or loss and cost of capital. This principle emphasizes that different sources of finance have different cost of capital. It should be remembered that the cost of capital moves inversely with risk. Thus, additional risk capital results in decline in the cost of capital.

1.11.3 **PRINCIPLE OF EQUITY POSITION :-**

The principle deals with defining the amount of working capital out of the total investment. According to this principle every rupee invested in the current assets should contribute to the net worth of the firm. The level of current assets may be measured with the help of law ratios:

- Current assets as a percentage of total sales and
- Current assets as a percentage of total assets.

1.11.4 **PRINCIPLE OF MATURITY OF PAYMENT:-**

The principle deals with the ability of a firm to meet the current liabilities. According to this principle, a firm attempts to pay matured liabilities from internal funds. Generally, shorter the maturity schedule of current liabilities in relation to expected each inflows the greater the inability to meet the obligations in time.\textsuperscript{11}

The greater the disparities between the maturities of firm's short term debt investment and its flow of internally generated funds, me
greater the risk and vices versa. A company should make every effort to relate maturity of payment to its flow of internally generated funds. There should be the least disparity between the maturities of a firm's short-term debt instrument and its flow of internally generated funds because greater risk is generated with greater disparity. A margin of safety should, however be provided for any short-term debt payment.

1.11.5 PRINCIPLE OF CIRCULATION :-

In a genuine management of working capital, the cycle of working capital should be minimum. In other words, the circulation of working capital should take minimum time period. The shorter the time period of circulation, the more peculiar is the management of working capital.

1.11.6 PRINCIPLE OF LIQUIDITY :-

In determination of firm's liquidity the proportion of net working capital and liquid funds plays a more important role than that of inventory. If there are assets like government securities, bonds, and debentures and share that known to be readily marketable they may be liquidated at a moment's notice when cash is needed. If these assets are not present in the business, the firm will stand in need of cash as it cannot obtain cash readily and the result will be mat the opportunity will go out of hand. In the same way it is also notable that when there is any excess of cash at any time, the firm can invest it in short term investment and maximize its profitability. It is also possible only when the liquidity is higher in working capital management.
1.11.7 PRINCIPLE OF ADEQUACY :-

Firms, which manage adequate working capital, always earn higher profit than the firms, which fail to manage adequate working capital. Often most of firms have excess working capital and many times they have inadequate working capital. As a result of inadequate working capital to pay their obligation, they have to borrow at a higher rate of interest and the higher rate interest decreases the profitability of an enterprise. On the other hand, if there is excess working capital, automatically the profitability of the concern will be less than that of proper management of working capital. This principle expresses that a firm should have adequate working capital to obtain the higher rate of return on capital employed.

1.12 FACTOR AFFECTING THE WORKING CAPITAL NEEDS :-

There is large number of factors upon which the working capital need of a concern depends such as size a nature of a firm, operations done by the firm, length of production cycles, stock turnover rate, change in economic circumstances etc. We can’t rank the above factors as each of them has different importance and influence. However the following factors are considered important when the working capital needs are determined.

A firm should plan its operations in such a way that it should have neither the lack of working capital nor it should have excess of working capital. There is no set of rules or formula to determine the
working capital requirement but there are so many factors that affect in determining the requirement of working capital. The factors mainly affect the size and nature of industries and firm. These factors are also changing from time to time. In general, following factors are affecting the requirement of working capital.

Numerous factors can influence the size and need of working capital in a concern. So no set rule or formula can be framed. It is rightly observed that, “There is no precise way to determine the exact amount of gross or net working capital for every enterprise. The data and problem of each company should be analyses to determine the amount of working capital.

Briefly, the optimum level of current assets depends upon following determinants.

1.12.1 NATURE OF BUSINESS:-
1.12.2 SIZE OF BUSINESS:-
1.12.3 MANUFACTURING CYCLE:-
1.12.4 PRODUCTION POLICY:-
1.12.5 WORKING CAPITAL CYCLE:-
1.12.6 SEASONAL VARIATIONS:-
1.12.7 CREDIT TERMS:-
1.12.8 RATE OF STOCK TURNOVER:-
1.12.9 RATE OF GROWTH OF BUSINESS:-
1.12.10 EARNING CAPACITY AND DIVIDEND POLICY:-
1.12.11 PRICE LEVEL CHANGES:-
1.12.12 BUSINESS FLUCTUATIONS:-
1.12.13 CONDITIONS OF SUPPLY:-
1.12.14 CREDIT POLICY OF ENTERPRISES:-
1.12.15 GROWTH AND EXPANSION:-
1.12.16 VOLUME OF SALE:-
1.12.17 LIQUIDITY AND PROFITABILITY:-
1.12.18 MANAGEMENT ABILITY:-
1.12.19 CASH REQUIREMENTS:-
1.12.20 TIME:-
1.12.21 TERMS OF PURCHASE AND SALE:-
1.12.22 INVENTORY TURNOVER:-
1.12.23 RECEIVABLE TURNOVER:-
1.12.24 BUSINESS CYCLE:-
1.12.25 VARIATION IN SALES:-
1.12.26 PRODUCTION CYCLE:-
1.12.27 PROFIT PLANNING AND CONTROL:-
1.12.28 ACTIVITIES OF THE FIRMS:-
1.12.29 TURNOVER OF CIRCULATING CAPITAL:-
1.12.30 INHERENT HAZARDS AND CONTINGENCIES:-
1.12.31 REPAYMENT ABILITY:-
1.12.32 AVAILABILITY OF CREDIT:-
1.12.33 OPERATION AND FINANCIAL EFFICIENCY:-
1.12.34 DIVIDEND POLICY:-
1.12.35 VALUE OF CURRENT ASSETS:-
1.12.36 GESTATION PERIOD:-
1.12.37 OTHER FACTORS:-
1.12.1 NATURE OF BUSINESS :-

The working capital needs are basically influenced by the nature of the business. Trading and financial firms require a working capital in large amount as they have to carry large stocks of a variety of merchandise to satisfy their customer’s varied demand. Such firms have low investment in fixed assets. On the other hand public utilities like electricity, water supply and railways require a large amount invested in fixed assets. Their working capital needs are nominal because they offer cash sales only and supply services, not products, and as such no funds are tied up in inventories and receivables. The manufacturing units also require sizable working capital along with fixed investments.

Trading and industrial concerns require more funds for working capital. Concerns engaged in public utility services need less working capital. For example, if a concern is engaged in electric supply, it will need less current assets, firstly due to cash nature of the transactions and secondly due to sale of services. However, it will invest more in fixed assets.

In addition to it, the investment varies concern to concern, depending upon the size of business, the nature of the product, and the production technique.

The general nature of business is also as important determinant of working capital. Working capital requirements are depend upon general nature and its activity to work. In public utility services, the working capital requirement is relatively slow as the inventories and goods rapidly change into cash. The large concerns that are engaged in production maintenance, a big part of investment consists of working capital. They have to maintain cash, inventory at very large level.
Manufacturing organization, however face problems of slow turnover of inventories and receivable and invest large amount in working capital. The industrial concern should have a fairly large amount of working capital though it varies from industries to industries depending on their assets structure.

### 1.12.2 SIZE OF BUSINESS :-

Size of the business directly affects the working capital requirements. Greater the size of a business unit generally large will be the requirements of working capital. Actually size may be measured in terms of the scale of operations. A firm with larger scale of operations will need more working capital than a small firm. However, in some cases even a smaller concern may need more working capital due to high overhead charges, inefficient use of available resources and other economic disadvantages of small size.

### 1.12.3 MANUFACTURING CYCLE :-

Needs of working capital is in direct proportion to length of manufacturing cycle i.e. longer the process period of manufacture, large is the amount of working capital needs. The longer manufacturing time blocks money in purchase of raw material and other suppliers, labor and service costs for long period before the finished product is finally obtained.
1.12.4 PRODUCTION POLICY :-

The need of working capital depends upon the production policy followed by the business unit. If a firm follows steady production policy, even when demand is seasonal by accumulating inventories during stock period with a view to meet high demand during the peak season it will require higher working capital. Even a firm may adopt the policy of varying its production schedule in accordance with the changes in demand. Thus, production policies may differ from firm to firm, depending upon the circumstances. According, the need for working capital will also vary.

In case of seasonal fluctuations in sales, production will fluctuate accordingly and ultimately requirement of working capital will also fluctuate. However, sales department may follow a policy of off-season discount, so that sales and production can be distributed smoothly throughout the year and sharp, variations in working capital requirement are avoided.

There are two options open to the enterprise, either they confine their production only to periods when goods are purchased or they follow a steady production policy throughout the year. In former case, there will be serious production problems. During the slack season, the firm will have to maintain the working force and physical facilities without adequate production or sale. The programmed accumulation of stock will naturally require an increasing amount of working capital, which will remain tied up for some months.
1.12.5 WORKING CAPITAL CYCLE :-

The time between purchase of inventory items and their conversion into cash is known as working capital cycle. At the initial stage of the unit the operating cycle starts with the purchase of raw materials at stores, it is converted into stock of finished goods through work-in-progress with increment of labor and service costs, finished goods converts into sales debtors’ and receivables and ultimately cash is realized and thus cycle continue till the existence of the unit. The speed with which the working capital completes one cycle determines the requirement of working capital longer the period of the cycle larger is the needs of working capital.

Less working capital will be needed with the increase in circulation of working capital and vice-versa. Circulation means time required to complete one cycle i.e. from cash to material, from material to work-in-progress, form work-in-progress to finished goods, from finished goods to accounts receivable and from accounts receivable to cash.

1.12.6 SEASONAL VARIATIONS :-

The certain industries availability of raw material is seasonal and cannot be obtained throughout the year/ in such a situation it becomes must to buy raw material in bulk to ensure the constant production during the entire year. Thus, a large amount remains block in the form of raw material and it gives size to more working capital needs generally, during the busy season, a firm. Requires larger, working capital than in the stack season.

It is not always possible to shift the burden of production and
sale to slack period. For example, in case of sugar mill more working capital will be needed at the time of crop and manufacturing.

1.12.7 CREDIT TERMS :-

The credit terms followed by the firm in dealing with its Creditors’ and debtors’ considerably affects its working capital needs. If a firm enjoys a credit from its Creditors’ and doesn’t allow credit to its customers, it requires less working capital than the firm purchases its inventories on cash and allow credit to its customers. Even in a small business unit requirement of working capital may be larger due to the credit policy followed by it.

If credit facility is available from banks and suppliers on favorable terms and conditions, less working capital will be needed. If such facilities are not available more working capital will be needed to avoid risk.

Creditors’ are the liability of any organization. They have interested in the assets of a company and security of loans. They want their advances should be sufficiently covered. This can only be possible when the assets are greater than its liabilities so that they may easily get money as and when needed and at the time of maturity.

1.12.8 RATE OF STOCK TURNOVER :-

Another influencing and important factor deciding the requirement of working capital in a firm is rate of stock turnover. Due to high rate of stock turnover sales gets easily converted into cash and ultimately the length of operating cycle decreases or say operating cycle moves fast and it results into less requirements of working capital. In
the opposite situation the effect will be inverse i.e. law rate will be inverse i.e. law rate of stock turnover increases the length of operating cycle and more working capital is needed.

1.12.9 RATE OF GROWTH OF BUSINESS :-

As a company grows, logically, larger amount of working capital will needed, though it is difficult to state any firm rules regarding the relationship between growth in the volume of a firms business and its working capital needs. However, it is true that the relation between rates of growth capital needs cannot be stated in a particular number, at the same time it can’t be ignored that they are related in direct proportion with each other.

1.12.10 EARNING CAPACITY AND DIVIDEND POLICY :-

The earning capacity differs from firm to firm as the quality of their products is different and the conditions like monopoly also affect it. Firms with high earning capacity receive cash profit that adds to the working capital amount. The dividend policy followed by the unit also affects the needs of working capital. A firm requires more working capital when rate of cash dividend irrespective of its generation of profits. While a firm that retains larger part of its profits and does not pay so high rate of cash dividend requires less working capital.

1.12.11 PRICE LEVEL CHANGES :-

Generally rising price level needs a higher investment in working capital. With rising prices the same legal of current assets need enhanced investment. Rising prices affects differently in different firms due to
variations in individual policies. However firm, which can immediately revise prices of their products upwards, may not face a serve working capital problem in periods of rising levels.

With the increase in price level more and more working capital will be needed for the same magnitude of current assets. The effect of rising prices will be different for different enterprises.

The rise price level will require an enterprise to maintain a higher amount of working capital. The companies, which can immediately reverse their product prices with rising price level, will not face a severe working capital problem.

1.12.12 BUSINESS FLUCTUATIONS :-

Business fluctuations refer to alternate expansion and contraction in general economic activities. In boom period, an upward swing in the economy leads to increased sales, resulting in an increase in the firms’ investment in inventory and receivables or book debts. On the other hand during depression, a decline in the economy may register a fall in sales and consequently, a fall in the levels of stocks and book debts.

1.12.13 CONDITION OF SUPPLY :-

If the supply of inventory is prompt and adequate, fewer funds will be needed. But, if the supply is seasonal or unpredictable, more funds will be invested in inventory. Investment in working capital will fluctuate in case of seasonal nature of supply of raw materials, spare parts and stores.
1.12.14 CREDIT POLICY OF ENTERPRISES :-

In some enterprises most of the sale is at cash and even it is received in advance while, in other sales is at credit and payments are received only after a month or two. In former case less working capital is needed than the later. The credit terms depend largely on norms of industries but enterprise some flexibility and discretion. In order to ensure that unnecessary funds are not tied up in book debts, the enterprise should follow a rationalized credit policy based on the credit standing of the customers and other relevant factors.

1.12.15 GROWTH AND EXPANSION :-

The need of working capital is increasing with the growth and expansion of an enterprise. It is difficult to precisely determine the relationship between volume of sales and the working capital needs. The critical fact, however, is that the need for increased working capital funds does not follow growth in business activities but precedes it. It is clear that advance planning is essential for a growing concern.

1.12.16 VOLUME OF SALE :-

This is directly indicated with working capital requirement, with the increase in sales more working capital is needed for finished goods and debtors”, its vice versa is also true.

This is the most important factor affecting the requirement of working capital. A firm maintains current assets because they are needed to support the operational activation, which result in sales. The volume of sale and the size of the working capital are directly related to each there. As the volume of sale increases the working capital investment increases and vices versa.
1.12.17 LIQUIDITY AND PROFITABILITY :-

There is a negative relationship between liquidity and profitability. When working capital in relation to sales is increased it will reduce risk and profitability on one side and will increase liquidity on the other side.

If firm is interested in maintaining the liquidity and wants to improve the liquidity, more working capital is required. If a firm desires to take a greater risk for bigger gains and losses, it reduces the size of its working capital in relation to its sales. A firm therefore should choose between liquidity and profitability and decides about its working capital requirement accordingly.

1.12.18 MANAGEMENT ABILITY :-

Proper co-ordination in production and distribution of goods may reduce the requirement of working capital, as minimum funds will be invested in absolute inventory, non-recoverable debts, etc.

1.12.19 CASH REQUIREMENTS :-

Cash is a part of current assets. The company should maintain the minimum cash level. It helps in the smoother functioning of business operation. It should be adequate and properly utilized. It is both the means and end of enterprise. Just as blood, gives life to the human body, in the same way cash gives profit and solvency to the working capital structure of an enterprise.
1.12.20 TIME :-

This is also an important factor that affects the requirement of working capital. If the time required in manufacturing goods is more (large), the investment in working capital is also greater and if the time is less than the amount invested in working capital is also less. Moreover, the amount of working capital depends upon inventory turnover and the unit cost of goods that are sold. The greater the cost the larger is amount of working capital.

1.12.21 TERMS OF PURCHASE AND SALE :-

If the credit terms of purchases are more favorable and those of sales less liberal, less cash is invested in inventory. With more favorable credit terms, working capital requirements can be reduced as the firms do get more time for payment to Creditors’ or suppliers. The credit granting policy of a firm affects the working capital requirement by influencing the size of account receivables.

1.12.22 INVENTORY TURNOVER :-

If it is high, the working capital requirement will be low. If it is low, working capital requirement reduces. Managing working capital is synonymous with controlling inventories. Good inventory management is helpful for the structure of working capital.

1.12.23 RECEIVABLE TURNOVER :-

It is necessary to have an effective control over receivables. Prompt collection of receivables and good facilities for setting payables result into low working capital requirements obtain maximum sales, keep
bad debt losses to minimum. Minimize the cost of investment etc. are the objectives of receivables management.

1.12.24 BUSINESS CYCLE :-

More working capital is required in the prosperity of business expansion and less working capital required at the time of depression. In the period of prosperity, additional funds are required to invest in plant and machinery to meet the increased demand. The depression phase lead to fall in the level of inventories and book debts and so less working capital is required. Business fluctuation influences the size of working capital mainly through the effect of inventories.

1.12.25 VARIATION IN SALES :-

A seasonal business requires the maximum amount of working capital for a relatively short period of time.

1.12.26 PRODUCTION CYCLE :-

The time to convert raw material into finished goods is referred to as the production cycle or operating cycle. The longer the duration, more working capital is required and lesser the duration less working capital is required. So it is an important factor, which affects the working capital requirement more working capital is required to finance the production cycle.

1.12.27 PROFIT PLANNING AND CONTROL :-

Adequate profit assists in generation of cash. It makes it possible for management to plough back a part of earning into the business and substantially build up internal financial resources.
1.12.28 ACTIVITIES OF THE FIRMS :-

A firm's policy regarding the sale also depends upon the requirement of working capital. If a firm's sells its goods to customer on credit basis, it requires more working capital as compared to cash sales.

1.12.29 TURNOVER OF CIRCULATING CAPITAL :-

Conversion of cash to inventory, inventory to finished goods, finished good to book debts of account receivables, book debt to cash account play an important role in judging the working capital requirement.

1.12.30 INHERENT HAZARDS AND CONTINGENCIES :-

An enterprise operating an industries subject to wide fluctuation in demand and prices for its products, periodic operating losses or rapidly changing technology, requires additional working capital.

1.12.31 REPAYMENT ABILITY :-

Enterprise repayment ability determines the level of its working capital.

1.12.32 AVAILABILITY OF CREDIT :-

An enterprise which can get credit from bank and suppliers easily on favorable conditions will operate with less working capital than an enterprise with such a facility.
1.12.33 OPERATIONAL AND FINANCIAL EFFICIENCY:-
Working capital turnover can only be improved with a better operational and financial efficiency of a firm.

1.12.34 DIVIDEND POLICY :-
A shortage of working capital often acts as powerful reason for reducing or shipping a cash dividend.

1.12.35 VALUE OF CURRENT ASSETS :-
A decrease in the real value of current assets compared to their book value reduces the size of the working capital. If real value of current assets increases, there will be an increase in working capital.

1.12.36 GESTATION PERIOD :-
Certain industries have a long gestation period with a result that a considerable number of years must elapse before production, operation can be carried on profitably. During this period income is insufficient and working capital is greater.

1.12.37 OTHER FACTORS :-
Certain other factors such as operating efficiency, management ability, irregular supply, import policy, assets structure, importance of labor, banking facilities etc also affects the working capital needs of a business.
With development of financial institutions, means of communication, transport facility, etc., needs of working capital is reduced because it can be available as and when needed.
In addition, absence of coordination in production and distribution policies in a company results in a high demand for working capital.

The absence of specialization in the distribution of products may enhance the need of working capital.

If the means of transport and communication in a country like India are not well developed, the industries may face a great demand for working capital by keeping raw materials.

The import policy of the government may also effect requirement of working capital for the companies as they have to arrange the funds for importing the goods at specified times.

The greater the amount of working capital lowers the amount of risk of liquidity.

1.13 SOURCES OF WORKING CAPITAL :-

The working capital need of a business unit can be classified as

- Fixed Working Capital Need
- Variable Working Capital Need

In a business unit, a part of working capital need remains permanently blocked in current assets to carry out day to day transactions and its minimum and can’t be expected to reduce at any time. This minimum level of current assets is permanent investment in fixed assets. The other part of working capital is to be required to meet the seasonal demands and some special exigencies such as ruse in prices, strikes etc. this part of working capital is variable which cannot be
permanently employed gainfully in business. The fixed portion of working capital should be generally financial from the fixed capital sources while the variable working capital needs of a business unit may be met from the short term sources of capital.

The various sources of working capital are as follows under two headings

1.13.1 LONG TERM SOURCES, FIXED WORKING CAPITAL, PERMANENT SOURCES :-

1.13.1.1 OWNER’S CAPITAL (SHARES) :-
1.13.1.2 BORROWED CAPITAL (DEBTORS’) :-
1.13.1.3 INTERNAL SOURCES (PLOWING BACK OF PROFIT) :-
1.13.1.4 PUBLIC DEPOSITS :-
1.13.1.5 LOANS :-

1.13.2 SHORT TERM SOURCES :-

1.13.2.1 MATCHING APPROACH :-
1.13.2.2 CONSERVATIVE APPROACH :-
1.13.2.3 AGGRESSIVE APPROACH :-

1.13.1 LONG TERM SOURCES, FIXED WORKING CAPITAL, PERMANENT SOURCES :-

Source of fixed working capital are of permanent nature and may be both external and internal. Among the internal sources the retained earnings and depreciation are more explicit. Retained earnings represent undistributed profit and are considerably depending upon factors like rate
of taxation and dividend policy. Generally this source is used for expansion but can also be used, as working capital depending upon how much it is available. The depreciation is the part of cost of production and is recovered subsequently in cash. Depreciation has greater chance to be utilized as a source of working capital for relatively longer period. Retained earnings and the depreciation funds may prove to be the best source of working capital relatively for longer period. These are normally not available in the initial stage of an enterprise.

Among the external sources the share capital, debentures and long term loans from financial institutions are more explicit. Issue of shares could be one way to raise the equity base. The probability of a successful issue of debentures seems to be rather meager. In the Indian Capital Market, issue of debentures has still to gain popularity. The mode of raising funds by issuing convertible debentures/ bonds is also considered, which may attract a number of investors. Loans from financial institutions and commercial banks are also the source of working capital. Externally, a large part of the working capital may be arranged in the form of loans from banks and financial institutions. These loans may take the form of unsecured or secured loans. The units may take overdrafts facilities from the commercial banks. Secured loans are the loans protected by the pledge of certain securities, which are normally inventories.

The issue of shares is likely to prove more advantageous than the sale of debentures because in the former case the management is relieved of the anxiety to return the amount on some fixed maturity date.
Sources of fixed working capital should facilitate an uninterrupted use for a sufficiently long period. The important five sources of fixed working capital are; owner’s capital, borrowed capital, internal sources, public deposits and loans. Let us discuss them in detail.

1.13.1.1 OWNER’S CAPITAL (SHARES) :-

Owner’s capital is an important source for permanent or fixed working capital. For company different types of shares like equity shares, preference shares, differed shares are sources of a long-term working capital. Preference shares enjoy the preferential right over equity shares in receiving dividend at a fixed rate and in regard to the payment of capital at the time of winding up the company. While equity shares do not have any fixed rate of dividend to receive and is to be paid subject to the availability of sufficient profits. A company can raise it fixed working capital by the issue of shares.

1.13.1.2 BORROWED CAPITAL (DEBTORS’) :-

Barrowed capital is a good and important source of raising long term or fixed working capital. For company's debentures is an instrument to obtain capital from outside i.e. borrowed capital. The debenture holders are the Creditors’ of the company and they are paid interest at fixed rate. Interest on debenture is an expense for the company which is charged against profit and loss account. The debentures are generally given floating charge on the assets of the company. Company can issue
different types of debentures like simple, naked or unsecured debentures, secured or mortgaged debentures, redeemable debentures, irredeemable debentures, convertible and non-convertible debentures. It is a good source of finance and beneficial for both the parties i.e. investors and the company. The interest on debentures is paid periodically on fixed rate. It is considered expense for the company so deducted from the profit and also debentures get priority on repayment at the time of liquidation. The firm issuing debentures also enjoys a number of benefits such as trading on equity, retention of control, tax benefits, etc.

1.13.1.3 INTERNAL SOURCES (PLOWING BACK OF PROFIT) :-

Internal sources refer to the surplus earnings in a business by the firm. It is a suitable source for an established firm for its expansion modernization and replacement etc. A surplus profit is ploughed back in a business and the firm is not required to pay any fixed rate interest, there is no need to keep securities, there is no dilution of control, it ensures table dividend policy and gains confidence of the public, excessive finance by internal source may lead to misuse of funds, monopolies, over capitalization and speculation, etc.

1.13.1.4 PUBLIC DEPOSITS :-

Now a day the public deposits are replaced by banking facilities. Public deposits are accepted directly from the public as fixed deposits by a business enterprise for raising short term and medium term
finance. Public deposits as a source of finance have a large number of advantages such as very simple, and commitment source of finance, taxation benefits, trading on equity, no need of securities and an inexpensive source of finance. Against it, it has certain dangers such as, it is uncertain, unreliable, unsound and inelastic source of finance. The RBI has also laid down certain limits on public deposits. Non banking concerns cannot borrow by way of public deposits more than 25% of its paid up capital and free reserves.

1.13.1.5 LOANS :-

The word ‘Loan’ has been popular after the banking facilities came into existence. Loans are one type of borrowed capital, a fixed rate interest is charged on it and the amount of the loan is to be paid by way of installment in a number of years.

1.13.2 SHORT TERM SOURCES :-

These sources may also be internal or external. Among the internal sources a reference may be made to tax provisions and dividend provisions. The deferred payment of taxes can be a source of variable working capital. Taxes are not paid from day to day but the accrued liability therefore, is indicated by reserves.

"Internal short terms funds are generated as equal to need of the business activities in the form of outstanding wages, salaries shares of the owner of the business in the profit of the firm and tax liabilities etc. There is always a time gap between the incurring of such short- term
liability and it's selling. During this interval the short-term sources provide funds. The internal short-term funds are also termed as spontaneous sources of short term credit."

External short-term sources of funds can be divided into open account trade credit and short-term borrowing. Trade credit is available for a short period and volume of this type of credit varies from company to company. The terms of trade credit are so determined that as far as possible, it is not utilized for other purpose, but if a concern fails to avail itself of the discount offered, it is comparatively costlier than others.

Short-term borrowing includes bank credit, public deposit and funds from other misc. sources such as selling of commercial papers and issuing of short-term promissory notes. Bank provides business unit with short-term funds to finance.

Working capital has various forms (a) Cash credit management and (b) Discounting of bills. Public deposits are generally accepted for a fixed period and if on maturity, they are not renewed, the amount of deposit has to be repaid. They cannot be obtained to an unlimited extent because of the various restrictions imposed by the government. However, the largest amount of short-term borrowing is obtained from banks particularly through cash credit arrangement. A Firm should take maximum advantage of the spontaneous finance sources. The approach a firm uses in mixing these sources can be matching, conservative or aggressive.

A firm can adopt different financing policies Vis–a-visa current assets. Three types of financing may be distinguished: long-term, short-
term and spontaneous financing. The important sources of long-term financing are shares, debentures, preference shares, retained earnings and long-term debt from financial institutions. Short-term financing refers to those sources of short-terms credit that the firm must arrange in advance. These sources include short-term bank loans, commercial papers, factoring receivables, and public deposits. Spontaneous financing refers to the automatic sources of short-term funds arising in the normal course of a business. The major sources of such financing are trade credit (Creditors’ and bills payable) and outstanding expenses. Spontaneous sources of finances are cost free. Therefore, a firm would like to finance its current assets with spontaneous source as much as possible. Depending on the mix of short-term and long-term financing, the approach followed by a company may be referred to as: 12

1.13.2.1 MATCHING APPROACH :-

The firm can adopt a financial plan which matches the expected life of assets with the expected life of the sources of funds raised to finance assets. Thus, a ten year loan may be raised to finance a plant with an expected life of ten years; stock of goods to be sold in thirty days may be financed with a thirty day bank loan and so on. The justification for the exact matching is that, since the purpose of financing is to pay for assets, the source of financing and the asset should be relinquished simultaneously. Using long-term financing for short-term assets is expensive as funds will not be utilized for the full period. Similarly, financing long-term assets with short-term financing is costly as well as inconvenient as arrangement for the new short-term financing will have
to be made on continuing basis.

When the firm follows matching approach (also known as hedging approach), long-term financing will be used to finance fixed assets and permanent current assets and short-term financing to finance temporary doer variable current assets. However, it should be realized that exact matching is not possible because of the uncertainty about the expected lives of assets. The matching financing is illustrated in figure – 7.

![Figure No. 1.7 :- Financing under matching plan](image)

The firm’s fixed assets and permanent current assets are financed with long-term funds and as the level of these assets Conservative approach increases, the long-term financing level also increases. The temporary or variable current assets are financed with short-term funds and as their level increases, the level of short-term financing also increases. Under matching plan, no short-term financing will be used if the firm has a fixed current assets need only.
1.13.2.2 CONSERVATIVE APPROACH :-

A firm in practice may adopt a conservative approach in financing its current and fixed assets. The financing policy of the firm is said to be conservative when it depends more on long-term funds for financing needs. Under a conservative plan, the firm finances its permanent assets and also a part of temporary current assets with long-term financing. In the periods when the firm has no need for temporary current assets, the idle long-term funds can be invested in the tradable securities to conserve liquidity. The conservative plan relies heavily on long-term financing and, therefore, the firm has less risk of facing the problem of shortage of funds. The conservative financing policy is shown in following figure-8

Figure No. 1.8 :- Financing under conservative plan
1.13.2.3 AGGRESSIVE APPROACH :-

A firm may be aggressive in financing its assets. An aggressive policy is said to be followed by the firm when it uses more short-term financing than warranted by the matching plan. Under an aggressive policy, the firm finances a part of its permanent current assets with short-term financing. Some extremely aggressive firms may even finance a part of their fixed assets with short-term financing. The relatively more use of short-term financing makes the firm more risky. The aggressive financing is illustrated in figure 9.

**Figure No. 1.9 :- Financing under aggressive plan**

1.14 STRUCTURE OF WORKING CAPITAL :-

The study of structure of working capital is another name for the study of working capital cycle. In other words, it can be said that the
study of structure of working capital is the study of the elements of current assets viz. inventory, receivable, cash and bank balances and other liquid resources like short-term or temporary investments. Current liabilities usually comprise bank borrowings, trade credits, assessed tax and unpaid dividends or any other such things.

The study of structure of working capital management is another name for the study of working capital cycle. In other words, we can say that the study of structure of working capital is the study of the element of current assets and current liabilities. Current assets consist of inventory, bills receivable, cash is hand, stores, bank balance and others liquid resources like short term or temporary investment. Current liabilities consist of bills payable, Creditors’, unpaid dividend, unpaid taxes and other such things which are payable within a year. This study of working capital is another name for study of elements of current assets over current liabilities.

1.14.1 CURRENT ASSETS :-

1.14.1.1 INVENTORY :-

1.14.1.1.1 RAW MATERIAL INVENTORIES :-

1.14.1.1.2 WORK-IN-PROCESS INVENTORY :-

1.14.1.1.3 SUPPLIES :-

1.14.1.1.4 FINISHED GOODS INVENTORY :-

1.14.1.2 CASH :-

1.14.1.3 RECEIVABLES :-

1.14.1.4 MARKETABLE SECURITIES :-

1.14.2 CURRENT LIABILITIES :-

1.14.2.1 CURRENT TRADE CREDITORS’ :-
1.14.2.2 CURRENT PROVISIONS :-

1.14.1 CURRENT ASSETS :-

1.14.1.1 INVENTORY :-

Inventory is major item of current assets. The management of inventories—raw material, goods-in-process and finished goods is an important factor in the short-run liquidity positions and long-term profitability of the company. Inventory and its importance in meeting customer's needs its management becomes important. Maintaining inventories also requires investment of capital. However, it should be adequate i.e. proper. Excess and inadequacy of capital both are very harmful for any company. A reduction i.e. inadequacy many times lead to slow down the firm's production and also halts its operation. Excess investment in inventory lowers the return on total assets and inventory turnover ratio. According to Harold and Dyckman. "The establishment of optimal inventory level is one part of determining the current asset portfolio and is one of the more important decision of the firm taken on a continually basis in relation to its operation."In general manufacturing concern has mainly three kinds of inventories:

1.14.1.1.1 RAW MATERIAL INVENTORIES :-

Uncertainties about the future demand for finished goods, together with the cost of adjusting production to change in demand will cause a financial manager to desire some level of raw material inventory. In the absence of such inventory, the company could respond to increased demand for finished goods only by incurring explicit clerical and other transactions costs of ordinary raw material for processing into finished
goods to meet that demand. If changes in demand are frequent, these order costs may become relatively large. Moreover, attempts to purchases hastily the needed raw material may necessitate payment of premium purchases prices to obtain quick delivery and, thus, raises cost of production. Finally, unavoidable delays in acquiring raw material may cause the production process to shut down and then re-start again raising cost of production. Under these conditions the company cannot respond promptly to changes in demand without sustaining high costs. Hence, some level of raw materials inventory has to be held to reduce such costs. Determining its proper level requires an assessment of costs of buying and holding inventories and a comparison with the costs of maintaining insufficient level of inventories.

On certainty about future demand for finished goods, together with the coats of adjusting production to the changes in demand cause a financial manager to desire some level of raw material inventory. Unavoidable delays in acquiring raw material may cause the production process shut down and then restart again raising cost of production. Under these conditions, the company cannot respond promptly to change in demand without sustaining high costs. Hence, some level of raw inventory has to be held to reduce such costs. Determining its proper level requires an assessment of cash of buying and holding inventories and a comparison with the cost of maintaining insufficient level of inventories. For maintaining proper level of inventories many methods like last in first out, first in first out, maximum level inventory, minimum level inventory, economic order quantity, average level etc. are used.
1.14.1.1.2 WORK-IN-PROCESS INVENTORY :-

This inventory is built up due to production cycle. Production cycle is the time-span between introduction of raw material into production and emergence of finished product at the completion of production cycle. Till the production cycle is completed, the stock of work- in-process has to be maintained.

This inventory is build up due to production cycle. Production cycle is the time span between introduction of raw material into production and emergence of finished product at the completion of production cycle. Therefore, work in progress is raw materials upon which work has been performed to change their form, size, physical or chemical properties. Till the production cycle is completed, the stock of work in progress should be maintained.

1.14.1.1.3 SUPPLIES :-

Stores and spares and other goods, which are consumed in the creation and distribution of goods and services.

1.14.1.1.4 FINISHED GOODS INVENTORY :-

Finished goods are required for reasons similar to those causing the company to hold raw materials inventories. Customer’s demand for finished goods is uncertain and variable. If a company carries no finished goods inventory, unanticipated increases in customer demand would require sudden increases in the rate of production to meet the demand. Such rapid increase in the rate of production may be very expensive to accomplish. Rather than loss of sales, because the
additional finished goods are not immediately available or sustain high costs of rapid additional production, it may be cheaper to hold a finished goods inventory. The flexibility afforded by such an inventory allows a company to meet unanticipated customer demands at relatively lower costs than if such an inventory is not held.

Thus, to develop successfully optimum inventory policies, the management needs to know about the functions of inventory, the cost of carrying inventory, economic order quantity and safety stock. Industrial machinery is usually very costly and it is highly uneconomical to allow it to lie idle. Skilled labor also cannot be hired and fired at will. Modern requirements are also urgent. Since requirements cannot wait and since the cost of keeping machine and men idle is higher, than the cost of storing the material, it is economical to hold inventories to the required extent. The objectives of inventory management are:

- To minimize idle cost of men and machines causes by shortage of raw materials, stores and spare parts.

- To keep down:
  - Inventory ordering cost.
  - Inventory carrying cost,
  - Capital investment in inventories.
  - Obsolescence losses

Receivables – Many firms make credit sales and as a result thereof carry receivable as a current asset. The practice of carrying receivables has several advantages viz., (i) reduction of collection costs over cash collection, (ii) Reduction in the variability of sales, and (iii) increase in the level of near-term sales. While immediate collection
of cash appears to be in the interest of shareholders, the cost of that policy may be very high relative to costs associated with delaying the receipt of cash by extension of credit. Imagine, for example, an electric supply company employing a person at every house constantly reading electricity meter and collecting cash from him every minute as electricity is consumed. It is far cheaper for accumulating electricity usage and bill once a month. This of course, is a decision to carry receivables on the part of the company. It may also be true that the extension of credit by the firm to its customers may reduce the variability of sales over time. Customers confined to cash purchases may tend to purchase goods when cash is available to them. Erratic and perhaps cyclical purchasing patterns may then result unless credit can be obtained elsewhere. Even if customers do obtain credit elsewhere, they must incur additional cost of search in arranging for a loan costs that can be estimated when credit is given by a supplier. Therefore, extension of credit to customers may well smooth out the pattern of sales and cash inflows to the firm over time since customers need not wait for some inflows of cash to make a purchase. To the extent that sales are smoothed, cost of adjusting production to changes in the level of sales should be reduced.

Finally, the extension of credit by firms may act to increase near-term sales. Customers need not wait to accumulate necessary cash to purchase an item but can acquire it immediately on credit. This behavior has the effect of shifting future sales close to the present time.

Therefore, the extension of credit by a firm and the resulting investment in receivables occurs because it pays a firm to do so. Costs of collecting revenues and adapting to fluctuating customer
demands may make it desirable to offer the convenience associated with credit to firm’s customers. To the extents that near sales are also increased, extension of credit is made even more attractive for the firm.

Customer demand for finished goods is uncertain and variable, if company carries no goods inventory, unanticipated increase in customer demand would require sudden increase in the rate of production to meet the demand. Such rapid increase in the rate of production may be very expensive to accomplish, rather than lose sales because the additional finished goods are not immediately available or sustain high cost of rapid additional production. It may be cheaper to hold a finished goods inventory. Normally finished goods include completely manufactured and inspected goods that are ready for sale.

Thus, to develop successfully optimum inventory policies the management needs to know about the functions of inventory, the cost of carrying inventory, economic order quantity and safety stock. Since requirement cannot wait since the cost of keeping machine and man idle hour is higher than the cost of storing the material. It is economical to hold inventories to the required extent.

■ OBJECTIONS OF INVENTORY MANAGEMENT :-

➢ To minimize idle cost of man and machine caused by shortage of raw material.

➢ To keep down inventory ordering cost, inventory carrying cost, capital investment in inventories, obsolescence losses, lead time, cost of holding inventory, reorder purchase/ variety reduction, materials planning, obsolete inventory scrap, quantity discount.
THE FOLLOWING FACTORS INFLUENCING THE INVENTORY ARE:

- Lead Time: It is the time taken for identifying the need and placing the order for purchasing goods from suppliers.
- Cost of holding inventory: The management should try to balance various costs so that the total cost may be minimized i.e. material cost, holding cost, and carrying cost, under stocking and over stocking cost.
- Reorder Point: Its shows when an order should be placed and depends upon consumption rate and the duration of lead-time.
- Variety reduction: If the stock is innumerable than it is imperative to reduce the number of items, which are particularly small items not usually, used.
- Material planning: To have successful material planning, it is necessary for an enterprise to adopt a technique, which considers the factors, which affect the material planning of availability of cash etc.
- Obsolete Inventory and sharp: Inventory may be obsolete due to change in design and demand and can only be minimized by rationalizing supply sizes and adopting correct measures and by proper maintaining of machines.
- Quantity Discount: the vendors offer it to the purchasers. In order to induce purchase, suppliers offer the reduced price of bulk order.
1.14.1.2 CASH :-

Cash is one of the most important tools of day-to-day operations, because it is a form of liquid capital, which is available for assignment to any case. It is often the primary factor, which decides the course of business destiny, the decision to expand a business may be determined by the availability of cash and the borrowings of funds will frequently be dictated by cash position. Cash in hand however a non-earning asset is. The optimum level of idle resources depends upon various factors such as manufacturing cycle, the sale and collection cycle, age of bills and its maturity date. It also depends upon its liquidity of other current assets and the matter of expansion. It is an important component also because it is the cash, which keeps the business going. It is always in the form of liquid funds including bank balances, which may be used for any purpose and at any time. Cash is both the means and end for a firm. Return on capital generally makes the payment of cash, dividends imperative and in case of liquidation cash becomes the final means of payment. There is not a single movement in the life of a business firm when cash is not important. Cash therefore, occupies a central place in the structure of working capital.

It has now become a practice with business enterprise to avoid too much redundant cash by investing a portion of their earning in assets, which are susceptible to easy conversion into cash. Such assets include Govt. Securities bonds debentures and shares that are known to be readily marketable and they may liquidate at any movement as and when needed.
1.14.1.3 RECEIVABLES :-

The present popular practice of acquiring commodities and services in exchange for a promise of future payment rather than exchange of goods desired in ancient time. The best form of debt is 'book debt'. It is in fact an inter-firm debt. From the seller point, it is trade debtors’ an asset and from the purchaser point of view, it is trade creditor as a liability.

It may also be true that the extension of credit by the firm to its customers may reduce the variability of sales over time. Customer confined to cash purchases may tend to purchase goods when cash is available to them. Even if the customers do obtain credit elsewhere, they must incur additional cost of search in arranging for a loan cost that can be estimated when credit is given by a supplier. Therefore extension of credit to customer may well smooth out the pattern of sales and cash inflows to the firms over time since customer need not wait for some inflows of cash to make a purchase. The extension of credit by firms may act to increase near term sales. Customer need not wait to accumulate necessary cash to purchase an item but can acquire it immediately on credit.

The determination of the amount of investment in receivable is a function of the volume sales and longer the terms of credit granted, the more will be the investment in receivables.

Promissory note and trade acceptance are the two forms of credit sales. These can be discounted before the maturity date. Receivables arising from periodic adjustment or sales are designated as accrued
receivables. Receivables like inventories carry some direct and indirect costs. Direct cost consists of allowances and concessions to customer and losses from bad debts. Indirect cost consist of credit and collection cost, cost associated with recording bill and preparing statement and sending statement of accounts and remainders for payment.

Thus the volume of receivable depends much upon the credit policy of a concern and they may depend upon the efficiency of the collection department. The total volume outstanding at any one time is determined by a firm's credit and collection policies. The role, which it plays in the total financial structure, depends upon the total enterprises' credit and collection policies, organization of credit and collection function, credit policy formulation etc.

The main objectives of receivables management are:

- Obtain maximum sales.
- Keep bad debts losses to the minimum.
- Minimize the cost of investment in book debts
- To minimize and denial servicing cost for book debts. Advantage of receivable management:
  - Reduction of collection costs over cash collection
  - Reduction in the variability of sales.
  - Increase in the level of near term sales.

1.14.1.4 MARKETABLE SECURITIES :-

In modern time, it has become a practice with business enterprise to avoid too much extra cash by investing a portion of their
earnings in assets, which are susceptible to easy conversion into cash. Such assets may be in form of cash, Govt. Securities, debentures, bonds or shares known as readily marketable securities. Corporate shares also come in this category.

1.14.2 CURRENT LIABILITIES :-

It is another main aspect of working capital:

1.14.2.1 CURRENT TRADE CREDITORS’ :-

These debts are payable in cash within a short period of a year or less. Until this liability falls due for payment it serves as a short-term source of finance.

1.14.2.2 CURRENT PROVISIONS :-

These are arising in normal course of business operation such as for taxation, dividends, interest etc. and mature for payment within a short period.

1.15 IMPORTANCE OF WORKING CAPITAL MANAGEMENT:-

The aim of working capital management is to manage a firm's current assets e.g. debtors’, receivables, cash in hand, cash at bank, stock etc. and firm's current liabilities viz. Creditors’, bills payable etc. in best
possible manner. If it does not maintain it in good manner, it is likely to become insolvent and may also become bankrupt. The current assets should be large enough to cover current liabilities in order to ensure a reasonable margin of safety. Each of the current assets must be managed efficiently in order to maintain the liquidity of a concern while not keeping too high level of any one of them so that the cost increases. Each of short-term sources of finance must be continuously manageable to ensure that they are obtained and used in the best possible way.

Proper management of working capital is very important for the success of a concern. "It aims at protecting the purchasing power of assets and maximizing the return on investment."

The manner of management of current assets to a very large extent determines die success of a concern. Constant management is required to maintain appropriate levels in the various working capital accounts. Cash and financial budget aid to establishing proper proportion, sales expansion, dividend declaration, plant expansion, and new product lines increased salaries and wages, rising price level etc. add strain on working capital maintenance.

"There are many aspects of working capital management which make it an important function of the financial manager." It has been found that the largest portion of financial manager's time is utilized in the management of working capital. It is particularly very important for small firms to manage their current assets and current liabilities very carefully.
"Failure of business is undoubtedly due to poor management and absence of management skill. Shortage of working capital, so often advanced as the main cause of failure of an industrial concern, is nothing but the clearest evidence of mismanagement of it which is so common."

The management of working capital also helps the management in evaluating various existing or proposed financial constraints and financial offerings. All these factors clearly indicate the importance of working capital of an enterprise. It has been emphasized that a firm should maintain a sound working capital position and that there should be optimum investment in working capital. Thus, there is a great need to manage working capital adequately. Small firms may not have much investment in fixed assets, but they have to invest in current assets such as cash, debtors’ and inventories. Further, the role of current liabilities in financing current assets is far more significant in case of small firms, as unlike large firms, they face difficulties in raising long-term finances.

There is great relationship between sales and working capital needs. As sales grow, a firm needs to invest more in inventories and book debts. These needs become very frequent and fast when sales grow continuously. Continuous growth in sales may also require additional investment in fixed assets but they do not indicate the same urgency as displayed by current assets.

It may, thus be concluded that all precautions should be taken for effective and efficient management of working capital. Failure of
business is undoubtedly due to poor management and absence of management skill.

In earning a reasonable rate of return, the functional complimentary, proportional and technical roles of working capital play a great part. Investment in working capital are relatively temporary in nature since the invested values are capable of being recovered within a short period of time depending upon the manufacturing cycle, as well as the collection cycles. In other words, it is the working capital, which after its transmutation into saleable products, actually generate revenue for business. Moreover, a low profit ratio can be geared to a high one by quickening the pace of working capital which besides providing the well spring for newer cycles will also increase die total realizable profit of a business enterprise. Adequate working capital provides the business a cushion against the adverse effects of shrinkage in the value of current assets insures to a great extent the maintenance of a company's credit standing and provides the meeting emergencies.

A fully equipped individual enterprise without adequate supply of materials to process or without cash to pay for workers' wages and other current expenses or a store without merchandize to sell is virtually useless. Consequently, the working capital position of any enterprise may readily become the controlling factor in determining the scope and character of its operation.

It plays technical role in maximization of the rate of return. An industrial concern can maximize its rate of return on the capital invested provided it keeps pace with the scientific and technological developments
taking place in the field in which a concern operates. It is merely common abuse that as soon as some technological and scientific development takes place, an industrial concern in order to accelerate its profitability should immediately introduce the same in its productive processes.

Management of working capital is also important for the success of a business. It has been emphasized that a business should maintain a sound working capital position and that there should not be an excessive level of investment in working capital. It has also been found that the largest portion of financial manager's time is utilized in the management of working capital like arranging term financing, negotiating favorable credit terms, controlling the movement of cash etc. On one hand, it maintains proper liquidity, while on other hand; it helps in increasing the profitability of the concern. If there is no liquidity, there cannot be good profitability. Profitability depends upon maximum utilization of all the components comprising working capital. If there is no proper planning of liquidity, a time may come when business may tend to drift towards liquidation. The amount of working capital funds reflects the solvency of business. The adequacy or inadequacy of working capital of a business is to be judged from the nature of business, its operating cycle, the working capital turnover etc.

The working capital plays the same role in the business as the role of heart in the human body. Working capital funds are generated and circulated in the business just like blood in the heart. This is because the working capital is known as the circulating capital.
Working capital has also a technical role to play in the maximization of the rate of return on capital invested provided it keeps pace with scientific and technological development taking place in the field to which it pertains.

The funds generated from the issue of shares, borrowings and from operations are used to pay Creditors’ for material etc. The material are processed, wages and overhead expenses are paid, this makes available stock of finished goods by sale of which either debtor are created or cash is receivable, thus generating profit A portion of profit is utilized for payment of tax, interest dividends. This working capital cycles continues throughout the life of business.

There should be a proper planning of liquidity. If there is no proper planning of liquidity a time may come when a business may tend to drift towards liquidation. The quantum of working capital funds reflects the solvency of the business but there is no single barometer to judge the efficiency of running a business. The adequacy or inadequacy of working capital in a business is to be judged from the nature of business, its operating cycle, the working capital turnover, the size of business and other factors. These factors influence the working capital needs of the business. The ratios may not be a guiding factor for all times to come in the life of a business. Management's attitude towards liquidity versus profitability is a vital contributing factor in assessing working capital requirements.

In a good management of working capital it is already decided that the funds are available for making payment for forthcoming obligation.
When an enterprise makes payment of each obligation in time, its goodwill automatically increases. The efficiency increases by the good management of working capital. If the firm manages a good working capital flow, it can utilize more effectively the fixed assets.

The following points throw ample light on the importance of working capital management.

- Risk Minimization
- Increase in good-will
- Increase in efficiency
- Increase in profitability
- More productivity of fixed assets

1.16. CONCLUSION :

The conceptual and contextual analysis of working capital leaves the following conclusions for us:

There are two concepts of working capital 'gross' and 'net'. According to the gross concept, working capital is the total of current assets. In turn of the net concept, working capital is the excess of current assets over current liabilities. Unless otherwise indicated it is the latter concept, which has been followed for the purpose of this study. This is because it permits a long run view of working capital of the enterprise selected for study.

In earning a reasonable rate of return, the functional, complementary, proportional and technical role of working capital plays a great part. Besides, the presence of an adequate working capital also
helps in maintaining an earning a good reputation in the business world.

The analysis of working capital should concern itself with its circulation, liquidity level and the structural health. Preparing a fund flow statement or conducting various ratio tests can analyze the working capital position of a company. Of the two the latter is better and of greater importance since it deals with each and every aspects of the working capital analysis and is useful for both the internal as well as external management.
REFERENCES :-


5. V.L. Gole, Fitzerald’s Analysis and Interpretation of Financial Statement.

6. Ibid., p.51


