

Study and analysis of working capital management in current business scenario



Management

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ABSTRACT

This paper is about to the various mode of working capital management. In current business scenario the role of working capital management is very crucial. Organization is more attentive for their working capital management. Working capital is a financial metric which represents the amount of day-by-day operating liquidity available to a business. Also known as operating capital, it is calculated as current assets minus current liabilities. A company can be endowed with assets and profitability, but short of liquidity, if these assets cannot readily be converted into cash. Gradual increase in profit results in capital growth of the firm. Increasing sales volume results in increasing profits. Sales are done on either cash or credit basis. Sale of goods will not be converted into cash immediately when sales are done on credit basis. Therefore additional capital is required to have uninterrupted business operations as the sales amount gets locked up in current assets like accounts receivable, inventory etc. Gradual increase in profit results in capital growth of the firm. Increasing sales volume results in increasing profits. Sales are done on either cash or credit basis. Sale of goods will not be converted into cash immediately when sales are done on credit basis. Therefore additional capital is required to have uninterrupted business operations as the sales amount gets locked up in current assets like accounts receivable, inventory etc.

Introduction

Working capital management involves the relationship between a firm's short-term assets and its short-term liabilities. The basic goal of working capital management is to ensure that a firm is able to continue its operations and that it has sufficient ability to satisfy both maturing short-term debt and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable, accounts payable and cash. Working Capital is the money used to make goods and attract sales. The less Working Capital used to attract sales, the higher is likely to be the return on investment. Working Capital management is about the commercial and financial aspects of Inventory, credit, purchasing, marketing, and royalty and investment policy. The higher the profit margin, the lower is likely to be the level of Working Capital tied up in creating and selling titles. For that cash is also the part of working capital management. Cash is the most liquid asset of all and is vital for existence of any business firm. Its efficient management is crucial to the solvency of the business because as we all know cash is the focal point of the funds flows in a business.

It can be understood in two senses, one is actual cash held by firm and deposits withdraw able on demand, and in another sense it includes marketable securities, which can be convertible into cash immediately. The goal of cash management is to reduce the amount of cash that is being used within the firm so as to increase profitability, but without reducing business activities or exposing the firm to undue risk in its financial obligations. Working capital is a financial metric which represents the amount of day-by-day operating liquidity available to a business. Also known as operating capital, it is calculated as current assets minus current liabilities. A company can be endowed with assets and profitability, but short of liquidity, if these assets cannot readily be converted into cash. Working capital is of two types. They both are interlinked with each other. In the first, working capital refers to gross working capital and in second it is understood in terms of net working capital.

CONCEPT OF WORKING CAPITAL

There are two concepts of working capital:

1. Gross working capital
2. Net working capital

The gross working capital is the capital invested in the total current assets of the enterprises current assets are those Assets which can convert in to cash within a short period normally one accounting year.

CONSTITUENTS OF CURRENT ASSETS

While dealing with the working capital management, this is the prime responsibility of the managers to understand the various constituents. Some of them are following

- 1) Cash in hand and cash at bank
- 2) Bills receivables
- 3) Sundry debtors
- 4) Short term loans and advances.
- 5) Inventories of stock as:
 - a. Raw material
 - b. Work in process
 - c. Stores and spares
 - d. Finished goods
6. Temporary investment of surplus funds.
7. Prepaid expenses
8. Accrued incomes.
9. Marketable securities.

In a narrow sense, the term working capital refers to the net working. Net working capital is the excess of current assets over current liability, or, say:

NET WORKING CAPITAL = CURRENT ASSETS - CURRENT LIABILITIES.

Net working capital can be positive or negative. When the current assets exceeds the current liabilities are more than the current assets. Current liabilities are those liabilities, which are intended to be paid in the ordinary course of business within a short period of normally one accounting year out of the current assets or the income business.

CONSTITUENTS OF CURRENT LIABILITIES

Following are the constituents of current liabilities.

1. Accrued or outstanding expenses.
2. Short term loans, advances and deposits.
3. Dividends payable.
4. Bank overdraft.
5. Provision for taxation
6. Bills payable.
7. Sundry creditors.

The gross working capital concept is financial or going concern concept whereas net working capital is an accounting concept of working capital. Both the concepts have their own merits.

The gross concept is sometimes preferred to the concept of working capital for the following reasons:

1. It enables the enterprise to provide correct amount of working capital at correct time.
2. Every management is more interested in total current assets with which it has to operate then the source from where it is made available.
3. It take into consideration of the fact every increase in the funds of the enterprise would increase its working capital.
4. This concept is also useful in determining the rate of return on investments in working capital. The net working capital concept, however, is also important for following reasons:

- It is qualitative concept, which indicates the firm's ability to meet to its operating expenses and short-term liabilities.
- IT indicates the margin of protection available to the short term creditors.
- It is an indicator of the financial soundness of enterprises.

FACTORS DETERMINING WORKING CAPITAL NEEDS

Nature of business: The working capital requirements of an enterprise are basically related to the conduct of the business. Public utility undertakings like Electricity, Water supply, Railways, etc. need very limited working capital because they offer cash sales only and supply services, not products and as such no funds are tied up in inventories and receivables. But at the same time have to invest fewer amounts in fixed assets. The manufacturing concerns on the other hand require sizable working capital along with fixed investments, as they have to build up the inventories.

Terms of sales and purchases: Credit sales granted by the concerns to its customers as well as credit terms granted by the suppliers also affect the working capital. If the credit terms of the purchases are more favorable and at the same time those of sales less liberal, less cash will be invested in the inventory. With more favorable credit terms, working capital requirements can be reduced.

Manufacturing cycle: The length of manufacturing cycle influences the quantum of working capital needed. Manufacturing process always involves a time lag between the time when raw materials are fed into the production line and finished goods are finally turned out by it. The length of the period of manufacture in turn depends on the nature of product as well as production technology used by a concern. Shorter the manufacturing cycle, lesser the working capital required.

Rapidity of turnover: If the inventory turnover is high, the working capital requirements will be low. With a better inventory control, a firm is able to reduce its working capital requirements. When a firm has to carry on a large slow moving stock, it needs a larger working capital as against another whose turnover is rapid. A firm should determine the minimum level of stock, which it will have to maintain throughout the period of its operation.

Business cycle: Cyclical changes in the economy also influence quantum of working capital. In a period of boom i.e., when the business is prosperous, there is a need of larger amount of working capital due to increases in sales, rise in price etc and vice-a-versa during period of depression.

Changes in technology: Changes in technology may lead to improvements in processing of raw materials, savings in wastage, greater productivity, and more speedy production. All these

improvements may enable the firm to reduce investments in inventory.

Seasonal variation: The inventory of raw materials, spares and stores depends on the condition of supply. If the supply is prompt and adequate the firm can manage with small inventory. However, if the supply were unpredictable and scant then the firm, to ensure the continuity of production, would have to acquire stocks as and when they are available and carry larger inventory on an average.

Market conditions: The degree of competition prevailing in the market place has an important bearing on working capital needs. When competition is keen, a larger inventory of finished goods is required to promptly serve customers who may not be inclined to wait because other manufacturers are ready to meet their needs.

Seasonality of operation: Firms, which have marked seasonality in their operations usually, have highly fluctuating working requirements. Let us take an example to illustrate this point. Consider a firm that manufactures fans. The sale of fans reaches a peak during the summer months and drops sharply during the winter period. The working capital need of such a firm is likely to increase considerably in summer months and decrease significantly during winter season.

Dividend policy: It has a dominant influence on the working capital position of a firm. If the firm is following a conservative dividend policy, the need for working capital can be met with retained earnings. Larger the working capital cycle, more is the requirement of working capital.

Conclusion

Every research has its own limitations but in this research after the factor analysis researcher observe various things simultaneously. There are nine major factors which have been extracted from this research after the quantitative analysis. Working capital management involves the relationship between a firm's short-term assets and its short-term liabilities. The basic goal of working capital management is to ensure that a firm is able to continue its operations and that it has sufficient ability to satisfy both maturing short-term debt and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable, accounts payable and cash. This is the strong tool for a manager to manage their funds for future obligations. It is a most important instrument for the organization to resolve the financial mayhem.