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WORKING CAPITAL MANAGEMENT: A CONCEPTUAL EXPOSITION

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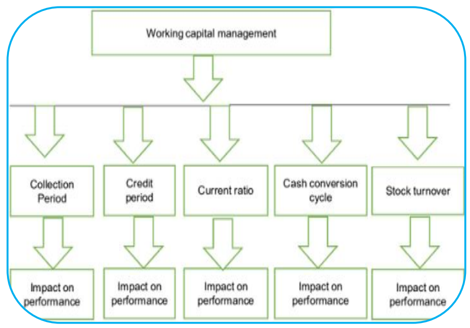
ABSTRACT:
The ineffective use of the resources at their disposal is typically an issue for developing economies. In these economies, capital is the most precious productive resource, and effective use of this resource encourages growth, lowers production costs, and, most importantly, increases the effectiveness of the productivity system. There are two types of capital that a company enterprise will need: fixed capital and operating capital. Therefore, the two main sources of a developing country's capital are fixed capital and working capital. Working capital enables the usage of productive capacity, which in turn ensures the continuation of the cyclical flow of production and sales. Fixed capital investments create productive capacity. As a result, working capital is often referred to as the heart of a company. Prior to now, financial management had a stronger focus on long-term financial choices. Working capital management, which is focused on making short-term financial decisions, seems to have received less attention in the financial literature. Leslie R. Howard correctly points out that a better understanding of working capital's significance and its adequate provisions can help businesses achieve their ultimate goal of maximizing financial return on the least amount of capital employed, as well as result in significant material capital cost savings.



KEYWORDS: *Current Assets, Current Liabilities, Liquidity,Working Capital Management.*

INTRODUCTION

Current assets less Current Liabilities equal Working Capital. It is the distinction between the input and outflow of funds in accounting jargon. Working capital is defined by professors H. G. Guthmann and H. E. Dougall as the difference between current assets and current liabilities. Working capital, according to Mayer J.N., is the amount of current assets that would be left in a business after all of its current liabilities have been settled. "Working capital is descriptive of that capital which is not fixed," said L. N. Chopde, D. H. Choudhri, and Sandeep Chopde. "However, the most usual use of working capital is to consider it as the difference between the book value of the current assets and current liabilities."

Circulating capital, according to Arvind A. Dhond, is defined as current assets of a corporation that are transformed in the normal course of business from one form to another, such as from cash to inventories, receivables to cash, and so forth. According to the traditional definition, working capital "Is the excess of current assets over current obligations," assert Professors Henry G. Gethmann and Herbert E. Gaugall.

The difference between current assets and current liabilities is what is known as working capital. The working capital is 50 lacks if we have 150 lacks in current assets and 100 lacks in current liabilities. Working capital is therefore the amount of current assets that remain in the company after all liabilities have been settled. It implies that the company has no ongoing obligations to fulfill when operating capital is present.

CONCEPT OF WORKING CAPITAL

Working capital refers to the funds needed for daily operations of business operations. It has been characterized by Brown and Howard to a river that is always present but whose water level is ever-changing. 6 The working capital circulation cycle is shown in the following diagram.

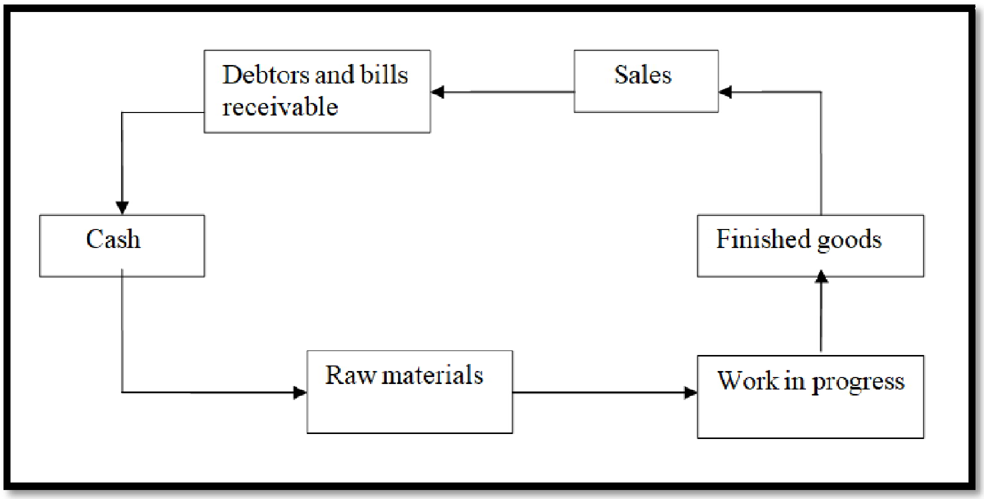


FIGURE-1: CIRCULATING CYCLE OF WORKING CAPITAL

Cash is transformed into inventory of raw materials and other stores since it is used to purchase these items. The production section is then given access to the shops and raw supplies. Wages are paid, other costs are incurred, and the work-in-progress is created before becoming the finished product. Customers purchase finished goods on credit. These buyers eventually pay cash for the things they acquire. The cycle is finished when "Cash" is obtained. This cycle is depicted in the graph above. Working capital can be thought of in two ways:

GROSS WORKING CAPITAL

Working capital is the general term for gross working capital. It speaks of the firm's acquisition of present assets. The assets that can be turned into cash within an accounting year are known as current assets. Items that fall under the category of current assets include raw material inventories, work-in-progress, finished goods, debtors, cash and bank balances, pre-paid expenses, accumulated income, advance payments, short-term investments, etc.

Gross working capital is a measure of working capital that places a greater focus on its quantity than its quality. From the perspective of a financial management, this idea is crucial for planning the ideal level of total working capital.

The gross concept makes sense from a business perspective. In the world of financial management, this idea is more often used.

The following equation can be used to determine gross working capital:

Total current assets = gross working capital.

NET WORKING CAPITAL

Entire current assets minus total current liabilities equals net working capital, or The difference between current assets and current liabilities, or the excess of all current assets over current liabilities, is known as net working capital. Creditors, bills that must be paid, short-term bank overdrafts, pending expenses, etc. are all included in total current liabilities. A positive or negative net working capital is possible.

Positive working capital is achieved when current assets are greater than current liabilities. When the current obligations exceed the current assets, working capital is negative. Crisis situations like this one are uncommon in corporate organizations.

The net working capital provides the organization with qualitative data. Accounting professionals, investors, creditors, and other anyone with an interest in the firm's liquidity and financial stability can all benefit from understanding the notion of net working capital. The following equation can be used to determine net working capital:

Net working capital = current assets – current liabilities

DEFICIT WORKING CAPITAL

Deficit working capital is the difference between current liabilities and current assets. Such an occurrence takes place when a corporation is on the verge of a significant crisis and is not entirely theoretical.

TYPES OF WORKING CAPITAL

Working capital may be divided into two bases;
Classification on the Basis of Financial Statement

- Balance Sheet
- Profit & Loss Account

Classification on the Basis of Variability
Permanent working capital

- Initial working capital
- Regular working capital

Variable working capital

- Seasonal working capital
- Special working capital

Classification on the Basis of Financial Statement

This classification has been done on the basis of financial statement because the information regarding the working capital is collected from the profit and loss account or balance sheet.

Balance Sheet: When the information regarding the working capital is collected from the balance sheet i.e. the items appearing in balance sheet, and 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

Profit & Loss Account:

Cash working capital: Cash working capital has arises when the items regarding the working capital is collected from the profit and loss account i.e. the items appearing in P&L Account. 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 into fished goods, finished goods to debtors and bill receivable through sales and conversion of bill receivable to cash etc. in case of manufacturing firm.

CLASSIFICATION ON THE BASIS OF VARIABILITY

Permanent Working Capital: Every firm is required minimum capital for investment in current assets for an entire year in order to satisfy the demands of customers even in the slack of season is known as permanent working capital. The amount of permanent working capital will increase with the growth of business. Permanent working capital again be subdivided into:

Initial working capital

REGULAR WORKING CAPITAL

Initial working capital: - It is the amount of working capital required at the inception of the business. In the initial stages, it is difficult for the firm to get credit from the bank on the other hand it may be required to grant credit to its customers. In such cash adequate working capital is required to initiate the circulating of capital and it moving till collection from the debtors more than payments.

Regular working capital: - It is the minimum amount of liquid capital needed to keep up the circulation of capital from cash to raw materials, raw materials into work in progress, work in progress into finished goods, finished goods into debtors and again debtors into cash. It is required routine transaction. It is necessary to maintain a continuous and regular flow of working capital. Regular working capital includes minimum stock of raw materials, finished goods and cash.

Variable Working Capital: An amount exceeding the permanent working capital required to meet the seasonal demands of the firm is called variable working capital. It varies with seasonal requirements and scale of operations in a business. Variable working capital may also be subdivided into;

- Seasonal working capital
- Special working capital

Seasonal working capital: It is the amount of working capital to meet the demands of seasonal requirements. During the season more working capital is required and during the off season less amount of working capital is required. Ex., For example a textile dealer would require large amount of funds a few months before Diwali.

Special working capital: Each business has to face uncertain circumstances. To meet such unexpected circumstances, a firm needs special funds exceeding its seasonal needs. Such working capital is called special working capital. Special working capital is that part of the variable working capital which required financing the special operations. Ex., Sudden increase in demand, Strikes, Fire, Floods, War, Drastic, Increase in taxes, Severe competition etc.

DETERMINATION OF WORKING CAPITAL

Establishing the necessary working capital is one of the most important short-term plans that is essential to the successful operation of the firm. It is crucial to estimate working capital accurately; otherwise, it could be overestimated or underestimated. The operating capital amount should be adequate. The two methods shown below can be used to calculate the amount of working capital needed.

- Percentage on Sales Method
- Operating Cycle Approach
- Regression Analysis Method

Percentage on Sales Method: It is a simple method of determining the level of working capital and its components. In this method, working capital is determined as present or forecast sales. It is determined on the basis of past experience. If over the years, relationship between sales and working capital is found to be stable, then this relationship may be taken as a base for determining the working for future. This method is simple, easy and useful in forecasting working capital.

Operating Cycle Method: Time which is needed to convert raw material into finished goods, finished goods into sales and account receivable into cash is called operating cycle. Under operating cycle method, time needed for different types of current assets and time lag needed for payment of purchase and expenses are considered to compute requirement of working capital. 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 for the purpose of estimating working capital is equal to the sum of the duration of each of these stages less the credit period allowed by the suppliers of the concern.

Symbolically it can be put thus
$O = R + W + F + D - C$

Where;
O = Duration of Operating Cycle
R = Raw Material Period (Average Stock of Raw Material / Average Raw Material & Storage Consumption per Day)
W =Work-in-Progress Period (Average Work-in-Progress Inventory / Average Cost of Production per Day)
F =Finished Goods Inventory Storage Period (Average Finished Stock Inventory / Average Cost of Goods Sold Par Day)
D =Receivable Stage
C = Creditors Payment Period

Regression Analysis Method: The regression analysis method is a very useful statistical technique of forecasting working capital requirement. In the sphere of working capital management it helps in making projection after establishing the average relationship in the past years between sales and the working capital and its components. The analysis can be carried out through the graphic portrayals (Scatter Diagram) or through mathematical formula. The relationship between sales and working capital may be simple and direct indicating complete linearity between sales and working capital may be simple and direct indicating complete linearity between the two or may be complex in differing degrees involving simple linear regression, or simple curvilinear regression and multiple regression situations. This method is suitable for simple as well as complex situations.

ADVANTAGES OF SUFFICIENT WORKING CAPITAL

In addition to fixed capital, a business must have an adequate level of working capital to purchase raw materials, pay for daily expenses such as salaries and wages, advertising, etc., and maintain fixed assets operational.

It is just as vital to the body as blood. Any organization's profitability largely depends on the amount of working capital available. It provides any company organization with vigor. It is an organization's lifeblood. The necessity of having enough working capital in any firm is highlighted by the following points.

1. Immediate payment to its suppliers: Having enough working capital allows a company to pay its creditors right away and take advantage of their cash and volume discounts.
2. Appropriate dividend distribution: Companies that lack operating capital invest their profits back into the company to make up for the shortfall. Despite making substantial income, these companies are unable to pay their shareholders an adequate dividend. On the other hand, if a company has enough working capital, it can declare and pay out a sizable dividend when profits are high enough. Shareholder satisfaction is increased, and the market value of shares is stabilized.
3. An increase in goodwill: If a company has enough operating capital, timely tax and discount payments may be achievable, allowing them to keep their goodwill.
4. Easy bank loans: A company with sufficient working capital and liquid assets can obtain bank loans on simple and advantageous conditions since the surplus of current assets over current liabilities serves as a strong security for unsecured loans.
5. Utilizing good possibilities: If a company has enough operating capital, it may take advantage of the opportunities present in the market. Buying items in bulk at a discount or at a cheaper cost, for instance.
6. Handling unforeseen circumstances: If working capital is sufficient, unanticipated circumstances may also be handled. To face the challenge during recessions, a sizable quantity of working capital is needed. Additionally, a sizable loss could result from the customer's failure to make their monthly payments of wages, salaries, etc.
7. Increased productivity of fixed assets: A business's fixed assets are more productive and efficient when it has enough working cash. For instance, without working capital, fixed assets are equivalent to guns that cannot fire because there are no cartridges if raw materials, labor, etc. are not available in sufficient quantities.

DISADVANTAGES OF EXCESS OR INADEQUATE WORKING CAPITAL

The company should keep a healthy working capital position. It ought to have enough working capital to maintain its activities. From the perspective of the company, both excessive and deficient working capital positions are risky. Excessive working capital translates to idle cash that don't generate revenue for the company. Inadequate working capital affects a company's profitability as well as the efficiency and disruption of production.

ADVERSE EFFECTS OF EXCESSIVE WORKING CAPITAL

Working capital that is too much or too little can both be hazardous. Excess working capital is used to describe idle cash that don't generate any revenue for the company. the following issues are referred regarded as having excessive working capital;
1) An excessive amount of working capital or surplus funds may result in pointless purchases and the building of inventory, which increases the risk of inventory mismanagement, theft, waste, and other losses.

2) Excessive working capital suggests a surplus of debtors and poor credit practices. This results in a higher incidence of bad debt, which eventually has an impact on the company's profits.
3) Excessive working capital is kept inactive and doesn't generate any revenue for the company, despite the fact that interest must be paid on it. The profits were lessened as a result.
4) An excessive amount of working capital points to poor firm management. It demonstrates that management is not concerned with efficiently using resources or promoting the economy. Additionally, shareholders believe they are not receiving a sufficient return on their investments. The value of the shares could decrease as a result of this poor rate of return on investments, which would make the shareholders unhappy.
5) Because a significant portion of money are not being used productively, excessive working capital may be just as detrimental as insufficient working capital.

Therefore, the immediate results of having too much working capital are;

- Low inventories
- Low working capital turnover
- High inventory costs
- Increased bad debt losses

Due to the following reasons, a company entity has too much working capital;

Excessive stock

An excessive amount of liquid funds; An excessive amount of marketable securities.

The availability of extra working capital, according to Ralph Kennedy and M. C. Mullen, may cause a lack of concern for expenses and consequent inefficiencies of operations.

Inadequate Working Capital Drawbacks

There is little doubt about the necessity of enough operating capital, just as food is vital for humans yet too much of it may be just as detrimental as not enough. A business's basis will be destroyed if it has too much working capital, which causes inflation, and too little, which results in famine.

Excessive working capital has a negative impact on the firm's profitability whereas insufficient working capital has a negative impact on the firm's solvency. Insufficient working capital denotes a lack of consistent funding to conduct daily business operations. A company may not have enough working capital for the following four reasons, in particular:

Underinvestment in inventories, underinvestment in marketable securities, underinvestment or insufficient investment in receivables, and a lack of available money, such as cash, are all examples of underinvestment.

A business with insufficient working capital will experience the following drawbacks;
1) It slows growth: The lack of working capital funds makes it harder for the company to take on profitable ventures.
2) A business may have to limit its operations to credit sales alone if it cannot afford to boost its cash sales. A corporation with sufficient working capital is able to finance huge inventories and may, therefore, place large orders.
3) Trade discounts are lost.
4) Cash discounts are lost: Some businesses will offer a cash discount off the total amount owed in an effort to get their debtors to pay their bills on time.

Due to a shortage of operating cash, fixed assets are not efficiently used. As a result, the company's profitability would decline.

When a company is unable to fulfill its immediate duties, its reputation suffers. The firm must therefore deal with stringent lending requirements.

CONCLUSION:

Working capital management plays an important role in the success of businesses because of its impact on liquidity and profitability. Against this background, the present study will make a comparative analysis of working capital management practices in Steel Authority of India Limited(SAIL) and Tata Steel. These two players have been selected for studying the working capital management practices practiced in public and private sector Indian Steel Companies.

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