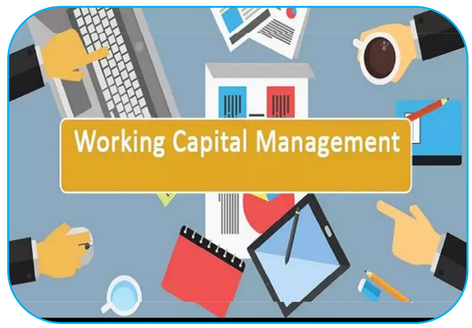
REVIEW OF RESEARCH
ISSN: 2249-894X
IMPACT FACTOR : 5.7631(UIF)
VOLUME - 10 | ISSUE - 9 | JUNE - 2021

A CONCEPTUAL STUDY OF WORKING CAPITAL MANAGEMENT

Sonam Verma
Magadh University, Bodhgaya.

ABSTRACT



Working Capital may be regarded as the Lifeblood of any business unit. Its effective management can do much more to the success of the business while its ineffective management will undoubtedly lead to ensured failure of the business. It is in the context that management of working capital assumes paramount importance. In the present scenario of cut throat competition, the business does not have any other option than cutting the cost of its operations in order to survive and continue to be financially healthy. There is no any other way than cutting the cost if the survives wants to improve the bottom line and fight the competition. Many organizations suffer the losses due to ineffective management of working capital and it is in this connection that effective management of working capital firms an absolute part of cost reduction. Mismanagement of working capital is found to be the leading cause of business failure in many organizations. Working capital is defined as the amount of funds needed to run day-to-day operations of the firm. It is that portion of the total funds of the business which is earmarked for meeting routine obligations like payment for raw materials, wages etc. As against this definition, fixed capital means investment of funds in fixed assets and hence, it is also known as capital expenditure. The word working capital however, may be understand in different ways by different people to suit their convenience. This paper is a modest attempt to study the conceptual framework of Working Capital Management.

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

INTRODUCTION

The primary purpose of working capital management is to enable the company to maintain sufficient cash flow to meet its short-term operating costs and short-term debt obligations. A company's working capital is made up of its current assets minus its current liabilities.

Current assets include anything that can be easily converted into cash within 12 months. These are the company's highly liquid assets. Some current assets include cash, accounts receivable, inventory, and short-term investments. Current liabilities are any obligations due within the following 12 months. These include accruals for operating expenses and current portions of long-term debt payments. Certain balance sheet accounts are more important when considering working capital management. Though working capital often entails comparing all current assets to current liabilities, there are a few accounts more critical to track.

Working capital management can improve a company's cash flow management and earnings quality through the efficient use of its resources. Management of working capital includes inventory management as well as management of accounts receivable and accounts payable.

Working capital management also involves the timing of accounts payable (i.e., paying suppliers). A company can conserve cash by choosing to stretch the payment of suppliers and to make the most of available credit or may spend cash by purchasing using cash—these choices also affect working capital management.

Types of Working Capital Management

According to the needs of business, the working capital may be classified into following two basis:

1) On the basis of periodicity
2) On the basis of concept

On the basis of periodicity: The requirements of working capital are continuous. More working capital is required in a particular season or the peck period of business activity. On the basis of periodicity working capital can be divided under two categories as under:

1. Permanent working capital
2. Variable working capital

Permanent working capital: This type of working capital is known as Fixed Working Capital. Permanent working capital means the part of working capital which is permanently locked up in the current assets to carry out the business smoothly. The minimum amount of current assets which is required to conduct the business smoothly during the year is called permanent working capital. For example, investments required to maintain the minimum stock of raw materials or to cash balance. The amount of permanent working capital depends upon the size and growth of company. Fixed working capital can further be divided into two categories as under:
1. Regular Working capital: Minimum amount of working capital required to keep the primary circulation. Some amount of cash is necessary for the payment of wages, salaries etc.
2. Reserve Margin Working capital: Additional working capital may also be required for contingencies that may arise any time. The reserve working capital is the excess of capital over the needs of the regular working capital is kept aside as reserve for contingencies, such as strike, business depression etc.

Variable or Temporary Working Capital: The term variable working capital refers that the level of working capital is temporary and fluctuating. Variable working capital may change from one assets to another and changes with the increase or decrease in the volume of business. The variable working capital may also be subdivided into following two sub-groups.
1. Seasonal Variable Working capital: Seasonal working capital is the additional amount which is required during the active business seasons of the year. Raw materials like raw-cotton or jute or sugarcane are purchased in particular season. The industry has to borrow funds for short period. It is particularly suited to a business of a seasonal nature. In short, seasonal working capital is required to meet the seasonal liquidity of the business.
2. Special variable working capital: Additional working capital may also be needed to provide additional current assets to meet the unexpected events or special operations such as extensive marketing campaigns or carrying of special job etc. Difference Between Permanent and Variable Working Capital: The distinction between permanent or fixed working capital and variable working capital or temporary working capital is of great importance in operating cycle and raising the funds. However, there is always a minimum level of current assets which is continuously required by the firm

to carry on its business operations. This minimum level of current assets is referred to as permanent or fixed working capital and is permanent in the same way as the firm's fixed asset.

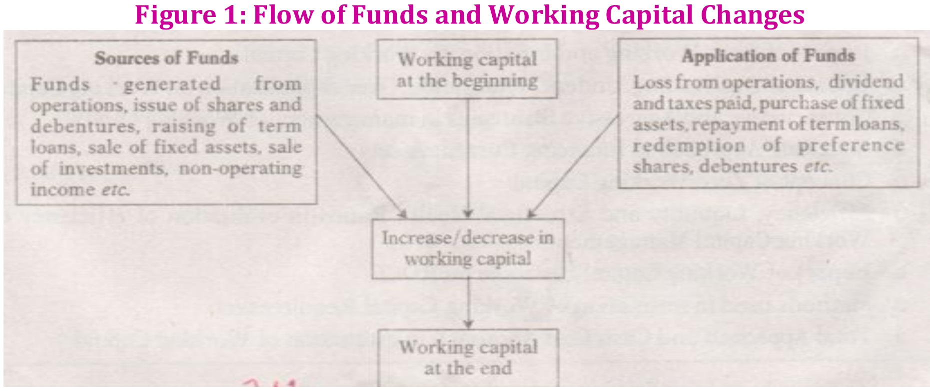
2) On the basis of concept: on the basis of concept working capital is divided into two categories as under:
(A) Gross Working Capital: Gross working capital refers to total investment in current assets. The current assets employed in business give the idea about the utilization of working capital and idea about the economic position of the company. Gross working capital concepts is popular and acceptable concept in the field of finance.
(B) Net Working Capital: Net working capital means current assets minus current liabilities. The difference between current assets and current liabilities is called the net working capital. If the net working capital is positive, business is able to meet its current liabilities. Net working capital concept provides the measurement for determining the creditworthiness of company.

Components of Working Capital

Working capital to a company is like the blood to human body. It is the most vital ingredient of a business. Working capital management if carried out effectively, efficiently and consistently, will ensure the health of an organization. A company invests its funds for long-term purposes and for short-term operations. That portion of a company's capital, invested in short-term or current assets to carry on its day to day operations smoothly, is called the 'working capital'. Working capital refers to a firm's investment in short-term assets viz., cash, short-term securities, amounts receivables and inventories of raw materials, work-in-process and finished goods. It refers to all aspects of current assets and current liabilities. The management of working capital is no less important than the management of long-term financial investment. Sufficient liquidity is necessary and must be achieved and maintained to provide that fund's to payoff obligation as they arise or mature. The adequacy of cash and other current assets together with their efficient handling virtually determine the survival of the company. The efficient working capital management is necessary to maintain a balance of liquidity and profitability. If the funds are tied-up in idle current assets represent poor and inefficient working capital management which affects the firm's liquidity as well as profitability.

Working capital is defined as 'the excess of current assets over current liabilities'. All elements of working capital are quick moving in nature and therefore, require constant monitoring for proper management. For proper management of working capital, it is required that a proper assessment of its requirement is made. Working capital is also known as circulating capital, fluctuating capital and revolving capital. The magnitude and composition keep on changing continuously in the course of business. If the working capital level is not properly maintained and managed, then it may result in unnecessary blockage of scarce resources of the company. Therefore, the Finance Managers should give utmost care in management of working capital.

Figure 1: Flow of Funds and Working Capital Changes



Current assets are those assets which are convertible into cash within a period of one year and are those which are required to meet the day to day operations of the business. The working capital management to be more precise the management of current assets. The current assets are cash or near cash resources. These include:

i) Cash and bank balances
ii) Temporary investments
iii) Short-term advances
iv) Prepaid expenses
v) Receivables
vi) Inventory of raw materials, stores and spares
vii) Inventory of work- in- progress
viii) Inventory of finished goods

Current Liabilities are those claims of outsiders which are expected to mature for payment within an accounting year. These include:

i) Creditors for goods purchased
ii) Outstanding expenses
iii) Short-term borrowings
iv) Advances received against sales
v) Taxes and dividends payable
vi) Other liabilities maturing within a year

Factors Determining Working Capital

The following factor determine the amount of working capital

1. Nature of Companies: The creation of a resource is a component of the size of a business and the organizations to which it has a place. Little organizations have more modest extents of money, receivables and stock than enormous enterprise. This distinction turns out to be more set apart in huge companies. A public utility, for instance, for the most part utilizes fixed resources in its tasks, while a marketing division relies by and large upon stock and receivable. Needs for working capital are in not entirely set in stone by the idea of a venture.

2. Demand of Creditors: Banks are keen on the security of credits. They maintain that their commitments should be adequately covered. They need how much security in resources which are more prominent than the responsibility.

3. Cash Requirements: Cash is one of the ongoing resources which are fundamental for the fruitful tasks of the creation cycle. A base degree of money is constantly expected to make a big difference for the tasks. Satisfactory money is likewise expected to keep up with great credit connection.

4. Nature and Size of Business: The functioning capital prerequisites of a firm are essentially impacted by the idea of its business. Exchanging and monetary firms have an extremely less interest in fixed resources, however require a huge amount of cash to be put resources into working capital. Retail locations, for instance, should convey enormous loads of various merchandise to fulfill the shifted and proceeds with request of their clients. Some assembling business, for example, tobacco assembling and development firms likewise need to put significantly in working capital and an ostensible sum in the proper resources.

5. Time: The degree of working capital relies on the time expected to assembling products. In the event that the time is longer, the size of working capital is perfect. Besides, how much working capital relies on stock turnover and the unit cost of the merchandise that are sold. The more prominent this expense, the greater is how much working capital.

6. Volume of Sales: This is the main variable influencing the size and parts of working capital. A firm keeps up with current resources since they are expected to help the functional exercises which bring about deals. They volume of deals and the size of the functioning capital are straightforwardly connected with one another. As the volume of deals increment, there is an expansion in the speculation of working capital-in the expense of activities, in inventories and receivables.

7. Terms of Purchases and Sales: Assuming the credit terms of buys are better and those of deals liberal, less money will be put resources into stock. With better credit terms, working capital prerequisites can be decreased. A firm gets additional opportunity for installment to leasers or providers. A firm which appreciates more noteworthy credit with banks needs less working capital.
8. Business Cycle: Business extends during times of success and declines during the time of sorrow. Thus, really working capital expected during times of flourishing and less during the times of wretchedness.
9. Production Cycle: The time taken to change over unrefined substances into completed items is alluded to as the creation cycle or working cycle. The more drawn out the creation cycle, the more prominent is the necessities of the functioning capital. An extreme attention to detail ought to be taken to abbreviate the time of the creation cycle to limit working capital necessities.
10. Liquidity and Profitability: In the event that a firm cravings to face a more prominent challenge for greater additions or misfortunes, it decreases the size of its functioning capital comparable to its deals. Assuming it is keen on working on its liquidity, it increment the level of its functioning capital. In any case, this strategy is probably going to bring about a decrease of the deals volume, and consequently, of productivity. A firm, hence, ought to pick either liquidity and productivity and make a choice about its functioning capital necessities in like manner.
11. Seasonal Fluctuations: Occasional changes in deals influence the degree of variable working capital. Frequently, the interest for items might be of an occasional sort. However inventories must be bought during specific seasons as it were. The size of the functioning capital in one time frame may, hence, be greater than that in another.

REFERENCE:

1. https://www.investopedia.com/terms/w/workingcapitalmanagement.asp#:~:text=Working%20capital%20management%20requires%20monitoring,payable%2C%20inventory%2C%20and%20cash.
2. https://www.srcc.edu/sites/default/files/B.A.(Hons.)%20Eco_Sem-II_Finance(GE)_WorkingCapital_RuchikaChoudhary.pdf
3. Benomyoung, R(2005), Measuring the Cash Conversion Cycle in An International Study Chain, Annual Logistics Research Network Conference Proceedings, Plymouth, UK.
4. Ceilia,Ricci and Nino(2000), International Working Capital practices in the UK, European Financial Management, Vol.6, No.1,pp. 69-84.
5. Chander, S and Kumar, R(2004), An Empirical Analysis of Some Aspects of Working Capital Requirements in Small Scale Textile Industry in Punjab, The Management Accountent, Vol.39, No. 5, pp.542-549
6. Christopher, M and Ryals, L(1999), Supply Chain Strategy: It's Impact on Shareholders Value, The International Journal of Logistics Management, Vol.10, no.1, pp.1-10
7. Deloof, M(2003), Does Working Capital Management Affect Profitability of Belgium Firms?, Journal of Business Finance and Accounting, Vol. 30, No.3-4, pp.328-342
8. Jain, P K, Singh, S and Kapoor, S(2011), Working Capital Management of Reliance Industries Limited- A Case Study, Journal of Accounting and Finance, Vol.25, No. 2, pp. 3-16
9. John, T A(1993), Accounting Measures of Corporate Liquidity, Leverage and Costs of Financial Distress, Financial Management, Vol.22, No.3, pp.91-100