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"A STUDY ON WORKING CAPITAL MANAGEMENTTOWARDS PRIVATE PRODUCTION COMPANY SECTORS - AN OVERVIEW "

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Abstract

Working capital management is part of the financial considerations that a finance manager needs to determine and plays an important role in determining the profitability of the firms. Working capital management is very essential one for any organization. Poor working capital management will affect a company in many ways. If a company does not have sufficient liquidity, it will not be able to meet its short term financial obligations, it will decrease its profitability and some time it may lead to shutdown the business. In view of its importance, this study aims to investigate on the effect of working capital management and its various types to describe the concept of working capital.

Key words: Current capital, reserve margin, fluctuation, sustain, solvency, exploitation, seasonal working capital, special working capital.

I- Introduction

Working Capital is the lifeblood and nerve centre of business. Just like circulation of blood in our human body for maintain life, working capital is very much essential for the smooth running of business. Efficient handling of working capital plays a major role in the successful functioning of a business enterprise. Working capital management is one of the most important functions of a company. So no business can run successfully without an adequate amount of working capital.

Working capital management

Finance lies at the root of an economic activity. Financial decisions play a significant role in managing operations of the business concern. No business can run successfully without adequate amount of working capital.

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Working capital is the short-term funds required for meeting day –to-day expenses.

It is also called Circulating capital, Revolving capital, Floating capital, Moving capital, Short-term capital. Working capital management involves deciding upon the amount and composition of current assets and how to finance these assets. Working capital refers to the part of the company's capital, which is required for financing short term or current assets such as cash, marketable securities, debtors and inventories.

Working capital involves two concepts "Gross" and "Net", the integration of both these concepts is necessary in order to understand the Working capital management from the point of view of risk, return and uncertainty. Working capital management is an internal part of overall corporate management to the management; working capital sphere throws a welcome challenge and opportunity. In a view of the multiplicity of factors exerting varied degrees of influence on working capital studies. A management has to be alert to the internal, external and Environmental developments and constantly plan and review its working needs and strategy.

Formula of working capital:

Working capital = Current Asset – Current Liabilities.

Definitions:

According to **Institute of Chartered Accounts of India(ICAI)**defines "Working Capital means the funds of revolving capital to meet day-to-day requirements of firm".

Shubinhas defined "Working capital is the amount of funds necessary to cover the cost of operating the enterprise".

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L.J.Gitman has defined Net working capital as "portion of the firm's current assets which are financed from long term funds".

II-Capital required for a business may be classified under two categories;

Fixed Capital: (Long-term funds): Capital required for purchase of fixed assets like land, building, plant, machinery, office equipment and furniture is called fixed assets.

Working capital: (Short-term funds): Capital required for purchase of raw materials and for meeting the day-to-day expenditure on salaries, wages, rents, advertising etc., is called working capital.

III- Objectives of the study

- The primary objective of the study is to know the relationship that exists between working capital management and profitability.
- To manage current assets.
- To maintain proper balance between current liabilities to meet financial obligations.
- To ensure smooth working of business.
- To minimize amount of capital employed in financing current assets.

IV- Significance of working capital:

- Investment in current assets represents portion of total investment.
- Working capital needed to purchase raw materials, spares, components, & parts.
- To pay wages & salaries.

- To incur day-to-day expenses.
- To meet packing and advertising cost.
- To provide credit facilities to customers.
- Amount of profit depend on sales.
- Sales do not convert into cash simultaneously.
- So sales are sustained by working capital.
- To maintain the inventories of raw materials, work-in-progress, stores and spares, finished stock.

V-Advantages of Working capital

Advantages of maintaining adequate amount of working capital is as follows:

- ✓ **Continuous production:** Adequate working capital ensures regular supply of raw material and continuous production.
- ✓ **Solvency of business:** Adequate working capital helps in maintaining solvency of the business by providing uninterrupted flow of production.
- ✓ **Easy loans:** A concern having sufficient working capital enjoys liquidity and good credit standing. Hence, it can secure loans from banks and others on easy and favorable terms.
- ✓ **Good will:** Sufficient working capital enables a business concern to make prompt payments and hence helps in creating and maintaining good will.
- ✓ **Cash discounts:** Adequate working capital also enables a concern to avail cash discounts on the purchase and hence it reduces costs.
- ✓ **Regular supply of raw materials:** Sufficient working capital ensures regular supply of raw materials and continuous production.

- ✓ **Ability to face crises:** Adequate of working capital enables a concern to face business crises such as depression, because during such period there is much pressure on working capital.
- ✓ **Exploitation of market condition:** A Concern has adequate working capital can exploit favorable market conditions. It can buy its requirements of raw materials in bulk when the market price is lower. Similarly, it can hold stock of finished goods to realize better prices.
- ✓ **High return on investment:** Adequate working capital facilitates continuous production and effective utilization of fixed asset. Because of this, the concern is able to generate more profits and ensure higher returns on investment.
- ✓ **Regular payments of expenses:** A company which as ample working capital can make regular payment of salaries, wages and other day-to-day commitments which raises the morale of its employees, increase their efficiency reduces wastages and costs and enhances production and profits.
- ✓ **High morale:** Working capital creates an environment of security, confidence, high morale and creates overall efficiency in a business.

VI - Classification of working capital:

Working capital may be classified into two ways.

- On the basis of concept
- On the basis of time

1.On the basis of concept: There are two concepts of working capital

- Gross working capital

- Net working capital

(i)Gross working capital:

Gross working capital is the capital invested in total current assets of the enterprise. Current assets are those assets which in the ordinary course of business can be converted into cash within a short period of normally one accounting year. It is also known as circulating capital or current capitals,for current assets are rotating in their nature.

(ii)Net working capital:

Net working capital is the excess of current assets over current liabilities. Net working capital may be positive or negative. When the current assets exceed the current liabilities of working capital is positive. Liabilities exceeds the current assets the working capital is negative.

2.On the basis of time:

- Permanent or fixed working capital
- Temporary or variable working capital

✓ **Permanent or fixed working capital:**

Permanent or fixed working capital is the minimum amount which is required to ensure effective utilization of fixed facilities and for support the normal operations of the business.

- **Regular working capital**
- **Reserve margin / reserve working capital**

✓ **Regular working capital:**

It is required for circulation of current assets from cash to inventory, from the inventories to receivables to cash and so on.

- ✓ **Reserve margin:**

It is the excess of the amount provided to meet contingencies like strikes, raise in prices, depression.

- ❖ **Permanent working capital is stable fixed over period.**
- ✓ **Temporary variable working capital:**

Temporary or variable working capital can be further classified as seasonal working capital and special working capital. Most of the enterprise has provided additional working capital to meet the seasonal needs.

- **Seasonal working capital**
- **Special working capital**

- ✓ **Seasonal working capital**

Seasonal working capital is required to meet seasonal demands of busy periods occurs at intervals.

- ✓ **Special working capital**

Special working capital is required to meet special exigencies like extensive marketing, campaigns or conducting research, advertising campaign, and fire

Danger of excessive working capital:

- Insufficient management

- Increased capital expenditure
- Over capitalization
- Misapplication of funds
- Chances of theft, waste, and losses will increase.

VII- Disadvantages of inadequate working capital:

- ✓ If concern which has inadequate working capital cannot pays its short-term liabilities its time. As a result it loses its reputation and faces difficult credit terms.
- ✓ It cannot buy its requirements in bulk and take advantages of cash discounts.
- ✓ Leads to inefficiencies increase in cost and reduction inprofit.
- ✓ Leads to decrease in return on investment.

VIII- Factors determining the working capital requirements:

Internal factors and External factors

Internal factors:

- Nature of business
- Size of business
- Length of production cycle (time)
- Production policy
- Terms of purchases
- Terms of sales
- Growth & expansion of business
- Price level changes

- Depreciation policy
- Dividend policy

External factors:

- Seasonal requirements
- Business fluctuations
- Condition of supply
- Market conditions & supply
- Import policy of the government
- Nature of competitions
- Taxation policy
- Repayment of loan
- Technological development

IX - Components of working capital:

1. Current assets And Current liabilities

Current assets such as given bellow:

(i) CURRENT ASSETS:

It is also called liquid assets are those resources of a firm which are either held in the form of cash or are expected to be converted into cash within accounting year or the operating cycle of the business.

(ii) Cash:

Cash is the most liquid assets. It is the current purchasing power in the hands of a firm and can be used for the purpose of acquiring some resources or paying some obligations cash includes actual money in hand and bank account.

(iii) Marketable securities:

They are temporary or short term investments in shares, debentures, bonds, and other securities. These marketable securities can be easily converted into cash within the accounting period.

(iv) Book debt or account receivable:

Book debts are the amounts due from debtors to whom goods or services have been sold on credit. These amounts are generally readable into cash within the accounting period. Debts which will be never collected are called bad debts.

(v) Bills receivable:

It represents the promises made in writing by debtors to pay definite sums of money after some specified period of time.

(vi) Stock or inventory:

Stock includes raw materials, work-in-progress and finished goods in case of manufacturing firms. Raw materials, work-in-progress inventories are needed for smooth production. Stock of finished goods is kept for serving customers on a continuing basis.

(vii) Prepaid expenses & accrued incomes:

Prepaid expenses & accrued incomes are also included in current assets prepaid expenses are the expenses of the future period paid in advance. Examples, prepaid insurance, prepaid rent or taxes, etc., are paid in advance.

CURRENT LIABILITIES:

Current liabilities are debts payable within an accounting current assets are converted into cash to pay current liabilities.

Current liabilitiesare such as given bellow:

(i) Sundry creditors:

Sundry creditors are also current liabilities towards suppliers from whom the firm has purchased raw materials on credit.

(ii) Bills payable:

Bills payable are the premised made in writing by the firm to make payment of a specified sum to creditors at some specific date. Bills payable have a life of less than year; therefore, they are shown as current liabilities in the balance sheet.

(iii) Bank borrowing:

Bank borrowing forms a substantial part of current liabilities of large no. of companies in India commercial banks advance short term credit to firms for financing for their current assets.

(iv) Expenses payable:

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Expenses payable is also the current liabilities. The firm owes payments to its employees and others at the end of accounting period for the service received in the current year. These are payable within a very short period.

(v) Income received in advance:

A firm can sometimes receive income for goods and services to be supplied in future.

IX Conclusion:

Working capital is the life line for every organization, irrespective of whether it's a manufacturing or service industry. Without proper working capital management no organization can function properly. Working capital is basic & most important requirement for carrying out day-to-day operations to ensure smooth running of the operations and to meet its short term obligations. It gives the much needed liquidity to the business. The working capital management has become an important tool to judge the performance of any business. Hence no business can run successfully without an adequate amount of working capital.