



# FINANCIAL MANAGEMENT

## WORKING CAPITAL

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## WORKING CAPITAL MEANING

Capital is the life blood of a business. The success of a business lies in the effective utilization of capital.

A business unit requires capital for

(i) LT purpose

(ii) ST purpose

LT funds are required – to purchase of fixed assets.

ST funds are required- to finance current assets

Working capital is the amount of funds required for meeting day-to day expenses.

## CIRCULAR PROCESS OF WORKING CAPITAL



## Working Capital Concept

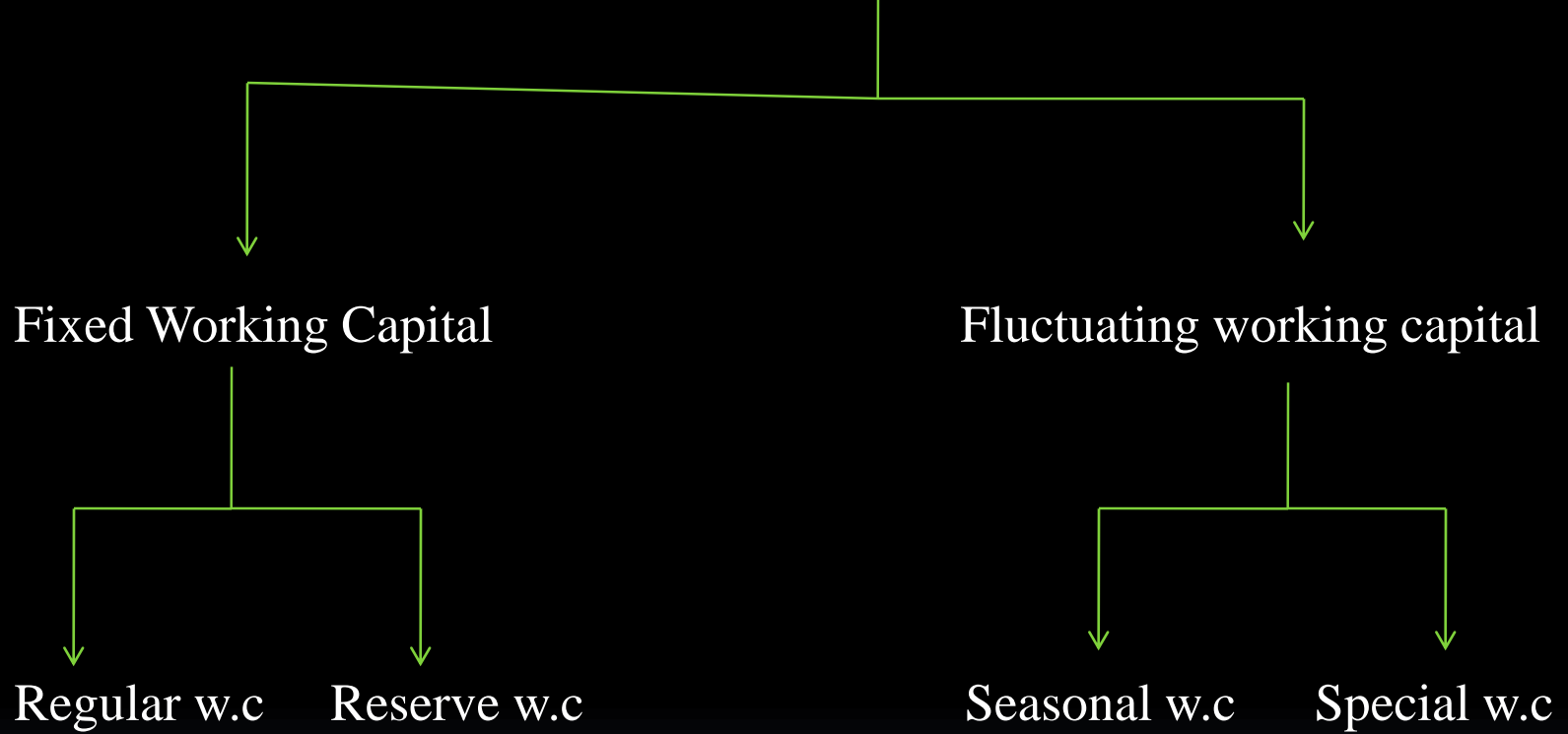
- (i) Gross working capital concept
- (ii) Net working capital concept

Gross W.C = Investment in current assets.

Net W.C = Current assets - Current liabilities.

Net working capital can be either positive or negative.

# TYPES OF WORKING CAPITAL



**PERMANENT WORKING CAPITAL:** Part of working capital which are permanently blocked in current assets.

(i) **REGULAR WORKING CAPITAL:** Minimum amount of working capital required to ensure circulation of assets.

(ii) **RESERVE WORKING CAPITAL:** Excess amount over the requirement for regular working capital.

**VARIABLE WORKING CAPITAL :** Over and above permanent working capital it is depend on the factors like peak boom etc.,

(i) **SEASONAL WORKING CAPITAL:** Additional amount of current assets required during more active business season of the year.

(ii) **SPECIAL WORKING CAPITAL:** Which is required for financing special operation of the business.

From the following estimates, calculate the average amount of working capital required.

1. Average amount locked up in stock:	per annum Rs.
Stock of finished goods and work-in-progress	10,000
Stock of stores, materials etc.	
8,000	

2. Average credit given:	
Local sales 2 weeks credit	1,04,000
Outside the state 6 weeks credit	3,12,000

3. Time available for payments:	
For purchases 4 weeks	78,000
For wages 2 weeks	2,60,000

Add 10% to allow for contingencies.

## Statement of Working Capital Requirement

Current Assets:	Rs.	Rs.
Stock of finished Goods and W.I.P	10,000	
Stock of Stores, material etc.	8,000	
Debtors-Local Sales(2Weeks)		
$1,04,000 \times 2/52$	4,000	
Outside the State(6weeks)		
$3,12,000 \times 6/52$	36,000	
	-----	58,000
<b>Less:Current liabilities:</b>		
Creditors(4Weeks) $78,000 \times 4/52$	6,000	
Outstanding wages(2Weeks) $2,60,000 \times 2/52$	10,000	
	-----	16,000
		-----
		42,000
Add: 10% for Contingencies		4,200
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Average Working Capital required		46,200
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## **Factors determining working capital requirements**

Adequate working capital is necessary for the successful running of any business.

### **❖ Nature of Business:**

In the case of public utility concerns like railways, electricity etc. most of the transactions are on cash basis. Further they do not require large inventories. Hence working capital requirements are low. On the other hand, manufacturing and trading concerns require more working capital since they have to invest heavily in inventories and debtors. Eg. Cotton or Sugar mill.

### **❖ Size of the Business:**

Generally large business concerns are required to maintain huge inventories for the flow of business. Hence, bigger the size, the larger will be the working capital requirements.

### **❖ Time consumed in manufacture:**

The time elapses between the beginning and end of the manufacturing process has an important bearing on the amount of working capital. The working capital required will be large, if it takes long time to make the finished product. Large amount of money will have to be kept as work-in-progress at all stages. For Eg. A ship building industry requires enormous working capital, as it takes 3 to 5 years to build a ship.

### ❖ **Seasonal fluctuations:**

A number of industries manufacture and sell goods only during certain seasons. For eg. The sugar industry produces practically all sugar between December and April. Their working capital requirement will be higher during the session.

### ❖ **Rapidity of turnover:**

Turnover means the speed with which the working capital is recovered by sale of goods. If the turnover is high, the amount of working capital required is rather small. For example, a news agent dealing in daily papers will have very rapid turnover and his working capital will be less. In case of Jewelers, sales are slow and hence very large amount of working capital is required.

### ❖ **Business cycle:**

The amount of working capital is also influenced by the cyclical changes in the economy. During the period of boom, the business is prosperous. In case of prosperity in business, the need for working capital is large because of increase in price, increase in sales etc., In a period of depression also the need for working capital is huge.

### ❖ **Labour intensive and Capital intensive industries:**

In labour intensive industries, large working capital is required because of heavy wage bill and more time taken for production. But the capital intensive industries require lesser amount of working capital because of heavy investment in fixed assets and shorter time taken for production.

### ❖ **Working Capital Cycle:**

In a manufacturing concern, the working capital cycle starts with the purchase of raw materials and ends with realization of cash from sale of finished products. The cycle is repeated again and again. When the working capital cycle works faster, the working capital requirements will be less. On the other hand, if the cycle is slow and time consuming, the need for working capital requirements will be longer.

### ❖ **Growth and Expansion of business:**

A growing concern needs more working capital to finance its increasing activities and expansion. But working capital requirements are low in the case of static concerns.

### ❖ **Dividend Policy:**

The dividend policy of a concern has a dominant influence on the working capital. A firm that maintains high rate of cash dividend irrespective of its generation of profits needs more working capital. On the other hand, a firm that follows conservative dividend policy, retains larger part of its profit needs less amount of working capital.

THANK YOU

BY

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