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**PG AND RESEARCH DEPARTMENT OF COMMERCE**

**I M.com**



**ADVANCED FINANCIAL MANAGEMENT**

**SUBJECT CODE: P16MC21**

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## Unit : V

Management of Working Capital :- meaning , significance and types of working capital, calculating operating cycle period and estimation of working capital requirement sources of working capital management of cash-receivable and inventory.

### **Working Capital:**

Capital required for a business can be classified under two main categories. They are:

- 1) Fixed capital
- 2) Working capital

### **Fixed capital:**

Capital required for a business of fixed assets like land, building, plant , machinery, office equipment and furniture is called Fixed capital .

### **Working capital:**

Capital required for purchases of raw materials and for meeting the day to day expenditure on salaries, wages, rent, advertising etc is called Working capital.

### **Concept of working Capital:**

- 1) Gross working capital
- 2) Net working capital

Purposes of working capital:

- a) To purchase of raw material
- b) To pay wages and salaries
- c) To incur day to day expenses
- d) To meet selling cost and advertising
- e) To provide credit facilities to customers
- f) To maintain inventories of raw material

Importance of working capital:

- 1) Continuous production
- 2) Solvency and goodwill

- 3) Easy loan
- 4) Cash discount
- 5) Regular payments of expenses
- 6) Exploitation of market condition
- 7) Ability to face crisis
- 8) High return on investment .

### **Factors:**

- A) Nature of business
- B) Size of business
- C) Time consumed in manufacture
- D) Seasonal fluctuation
- E) Fluctuations in supply
- F) Speed of turnover
- G) Terms of sales
- H) Terms of purchase
- I) Labour intensive VS Capital intensive industries
- J) Growth and expansion of business
- K) Price level changes
- L) Dividend policy
- M) Operational efficiency
- N) Level of taxes.

### **Sources of W C:**

- 1) Financing Of Permanent Working Capital
- 2) Financing of temporary or variable working capital.

#### Financing Of Permanent Working Capital:

1. Issue of shares
  - a) Equity shares
  - b) Preference shares
2. Issue of debentures
3. Public deposit

4. Ploughing back of profit

5. loan from financial institution

## **2. Financing of temporary or variable working capital.**

### **1. INTERNAL SOURCES:**

a) Depreciation fund

b) Provision for taxation

c) Accrued expenses

### **2. EXTERNAL SOURCES:**

a) Trade credit

b) Commercial papers

c) Bank credit

d) Advances

e) Loan from directors

f) Installment credit

### **Determining the Working Capital Financing Mix:**

- 1) Matching /Hedging approach
- 2) Conservative approach
- 3) Aggressive approach

Estimating working capital requirement :

- 1) Total quantity of unit to produced throughout the year
- 2) The total cost incurred on material, labour and overhead
- 3) The length of production cycle or work in progress
- 4) The length of sales.
- 5) The average period of credit allowed to debtors
- 6) The average period will remain in the warehouse
- 7) The amount of cash required allowed to debtors
- 8) The average period of credit allowed by creditor
- 9) Time lag in payments of wages and overheads
- 10) The length of time for which raw material.

### **Methods Of Calculating Working Capital Requirement :**

- 1) By determining the amount of current assets and liabilities.
- 2) Operating cycle methods
- 3) Percentage of sales methods .