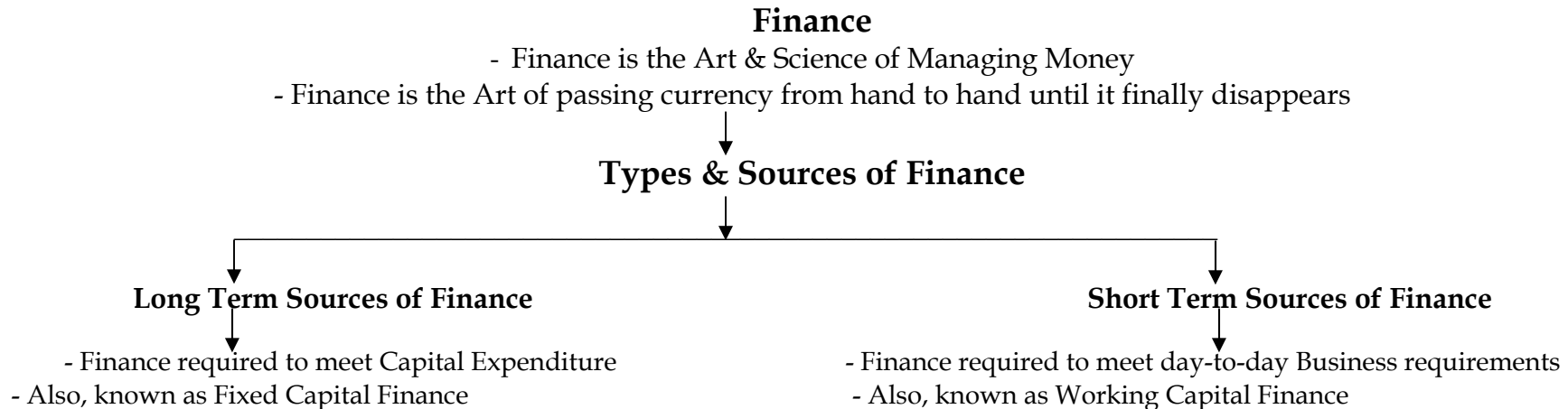
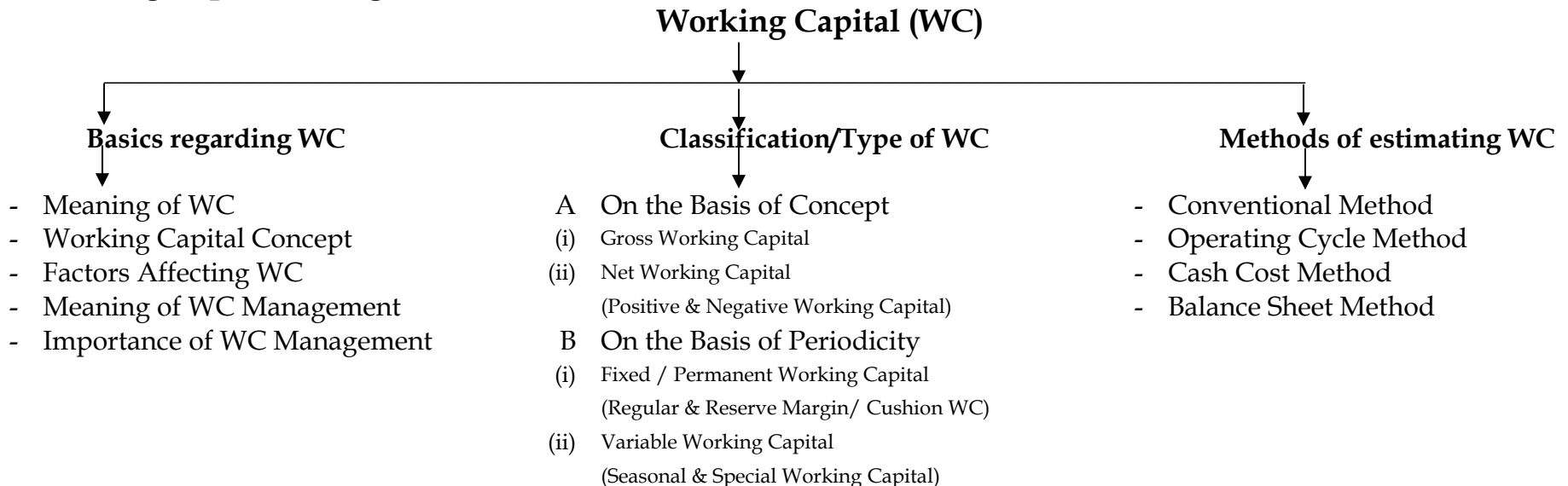


MANAGEMENT OF WORKING CAPITAL

1. Meaning and Types of Finance:



2. Working Capital Management:



Meaning of Working Capital:

- Working Capital is the amount of Capital that a Business has available to meet the day-to-day cash requirements of its operations
- Working Capital is the difference between resources in cash or readily convertible into cash (Current Assets) and organizational commitments for which cash will soon be required (Current Liabilities)
- It refers to the amount of Current Assets that exceeds Current Liabilities (i.e. CA - CL)
- Working Capital refers to that part of the firm's Capital, which is required for Financing Short-Term or Current Assets such as Cash, Marketable Securities, Debtors and Inventories. *Working Capital is also known as Revolving or Circulating Capital or Short-Term Capital*

Working Capital Concepts:

- **Gross Concept:** It means Current Assets. This is known as **Quantitative** aspect of Working Capital
(Focus is on (i) Optimum Investment in Current Assets and (ii) Financing of Current Assets)
- **Net Concept:** It means difference between Currents Assets & Current Liabilities. This is known as **Qualitative** aspect of Working Capital
(Focus is on (i) Liquidity Position of the Firm and (ii) WC Amount that can be financed by Permanent sources of Funds)

Meaning of Operating Cycle/Working Capital Cycle:

- Cash → Raw-Materials → Work-in-Process → Finished Goods → Cash

Factors affecting Working Capital/ Determinants of Working Capital:

- Nature of Business/ Industry; Size of Business/Scale of Operations; Growth prospects
- Business Cycle; Manufacturing Cycle; Operating Cycle & Rapidity of Turnover;
- Operating Efficiency; Profit Margin; Profit Appropriation
- Depreciation Policy; Taxation Policy; Dividend Policy and Government Regulations

Approaches (Methods) of estimating Working Capital:

- **Conventional Method:** Matching of Cash Inflows & Outflows. This method ignores Time Value of Money
- **Operating Cycle Method:** Debtors + Stock (RM/WIP/FG) - Creditors. This method takes into Account length of Time which is required to convert cash into resources, resources to final product, final product to Debtors and Debtors to Cash again.
- **Cash Cost Technique:** Working Capital forecast is done on Cost Basis (i.e. taking P&L items into account)
- **Balance Sheet Method:** Working Capital forecast is done on various Assets & Liabilities (i.e. taking B/S items into account)

Meaning of Working Capital Management:

- Working Capital Management is concerned with the problems that arise in attempting to manage the Current Assets, Current Liabilities and the inter-relationship that exists between them
- Working Capital Management means the deployment of current assets and current liabilities efficiently so as to maximize short-term liquidity
- Working capital management entails short term decisions - generally, relating to the next one year period - which are "reversible"
- Two Steps involved in the Working Capital Management:
 - (i) Forecasting the Amount of Working Capital
 - (ii) Determining the Sources of Working Capital

Importance of Working Capital Management:

- Working Capital is the Life Blood of the Business
- Fixed Assets (Long Term Assets) can be purchased on Lease/Hire Purchase but Current Assets cannot be
- Liquidity V/s Profitability

Objectives of Working Capital Management:

- Deciding Optimum Level of Investment in various WC Assets
- Decide Optimal Mix of Short Term and Long Term Capital
- Decide Appropriate means of Short Term Financing

Process/Steps Involved in Working Capital Management:

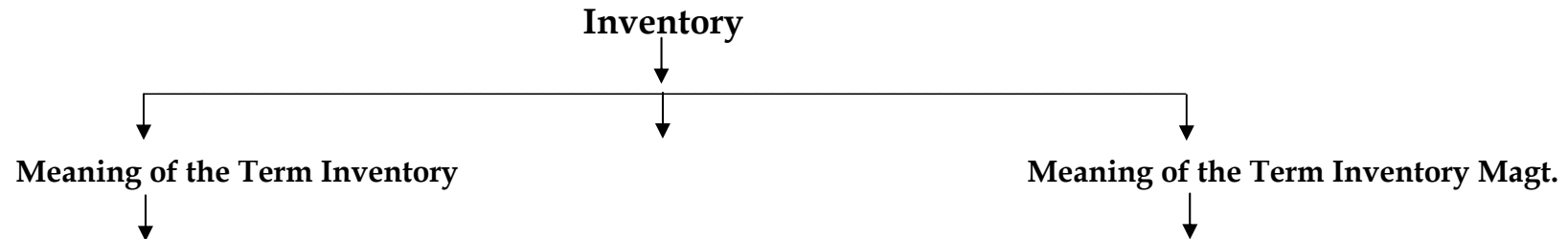
- Forecasting the Amount of Working Capital
- Determining the Sources of Working Capital

Different Aspects of Working Capital Management:

- Management of Inventory
- Management of Receivables/Debtors
- Management of Cash
- Management of Payables/Creditors

MANAGEMENT OF INVENTORY

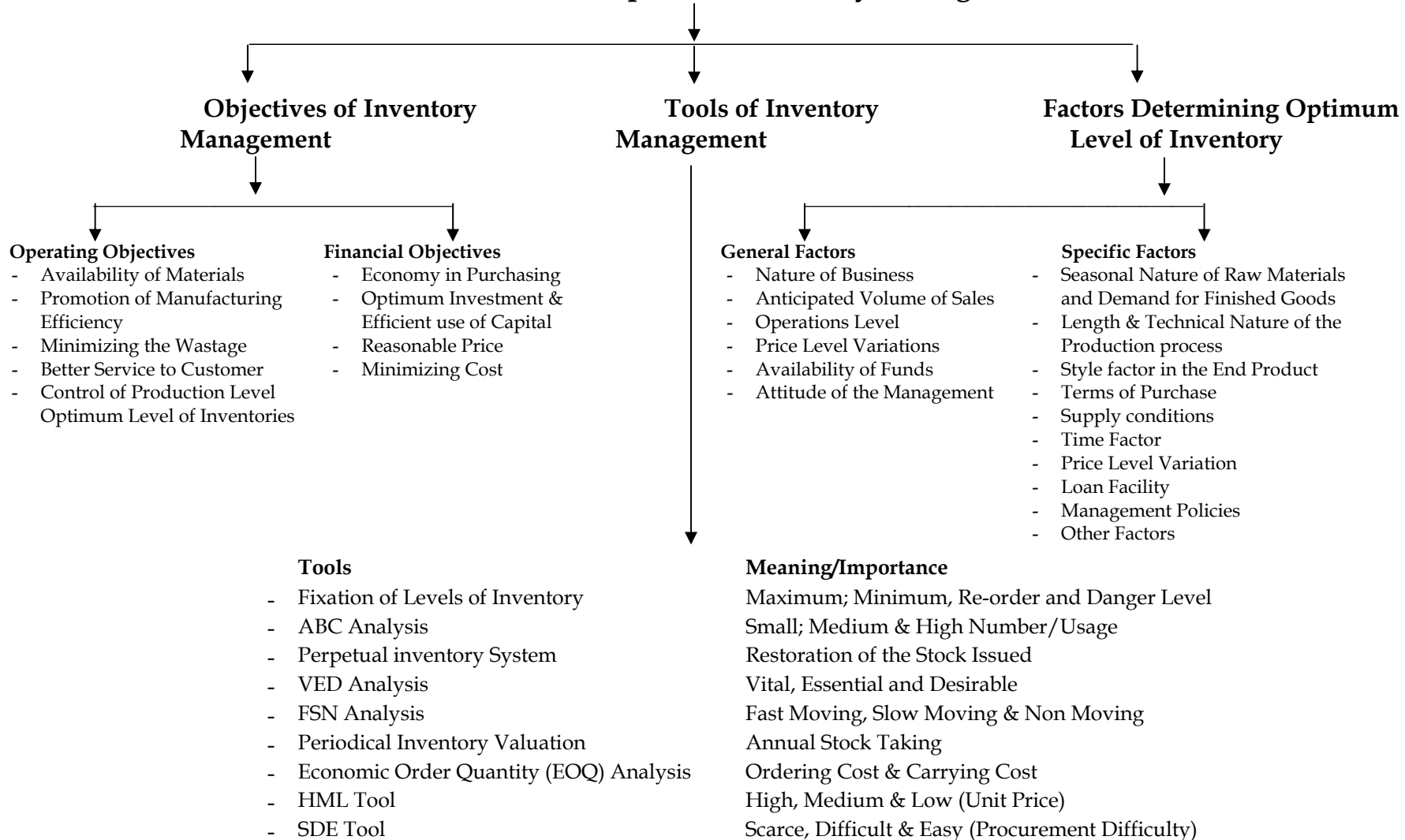
1. Meaning of Inventory and Inventory Management:



Inventory means Tangible property which is held:		Inventory Management means:	
-	For Sale in the ordinary course of Business OR;	-	An Optimum Investment in the Inventories
-	In the process of Production (i.e. WIP) for Sale OR;	-	Striking balance between Adequate Stock & Investment
-	For Consumption in the production of good & services which will be used for sale in the ordinary course of Business	-	Maintain Adequate Stock and that too by keeping Investment at Minimum Level. It is also known as Optimum Level of Inventory
Inventory Includes Raw-Material, FG, WIP, Spares, Consumables etc.		Maintaining Inventory at the Optimum Level is called Inventory Magt.	

2. Various Aspects relating to Inventory Management:

Various Aspects of Inventory Management



3. Important Formulas:

(a) **Maximum Level:** (*Maximum Quantity of Stock to be held*)

$$\text{Maximum Level} = (\text{Reorder Level} + \text{Reorder Quantity}) - (\text{Minimum Usage} \times \text{Minimum Reorder Period})$$

(b) **Minimum Level:** (*Minimum Quantity of Stock to be held*)

$$\text{Minimum Level} = (\text{Reorder Level}) - (\text{Normal Usage} \times \text{Normal Reorder Period})$$

(c) **Reorder Level:** (*Demand in the Lead Time*)

$$\text{Reorder Level} = (\text{Maximum Consumption} \times \text{Maximum Reorder or Delivery Period}) \text{ OR}$$

$$\text{Reorder Level} = (\text{Minimum Level}) + (\text{Normal Consumption} \times \text{Normal Delivery Period})$$

(d) **Danger Level:**

$$\text{Danger Level} = (\text{Minimum Rate of Consumption} \times \text{Emergency Delivery Time}) \text{ OR}$$

$$\text{Danger Level} = (\text{Average Consumption} \times \text{Maximum Reorder period for Emergency Purchases})$$

(e) **Lead Time:**

Time Lag between the Indenting and Receipt of Materials **OR**

Time normally required for obtaining fresh supply of Materials

(f) **Economic Order Quantity:**

$$\text{EOQ} = \sqrt{\frac{2AB}{CS}} = \sqrt{\frac{2 \times \text{Ordering Cost} \times \text{Demand}}{\text{Holding Cost}}} = \text{Lowest of (Carrying Cost + Ordering Cost)}$$

Where, A = Annual Usage/Annual Consumption

B = Buying Cost/Ordering Cost

C = Cost Per Unit

S = Storage Cost/Cost of Carrying Inventory

Assumptions of EOQ Model:

(i) Known and Constant Demand

(ii) Known and Constant lead time

(iii) Instantaneous receipt of material

(iv) No quantity discounts

(v) Only order (setup) Cost and holding cost

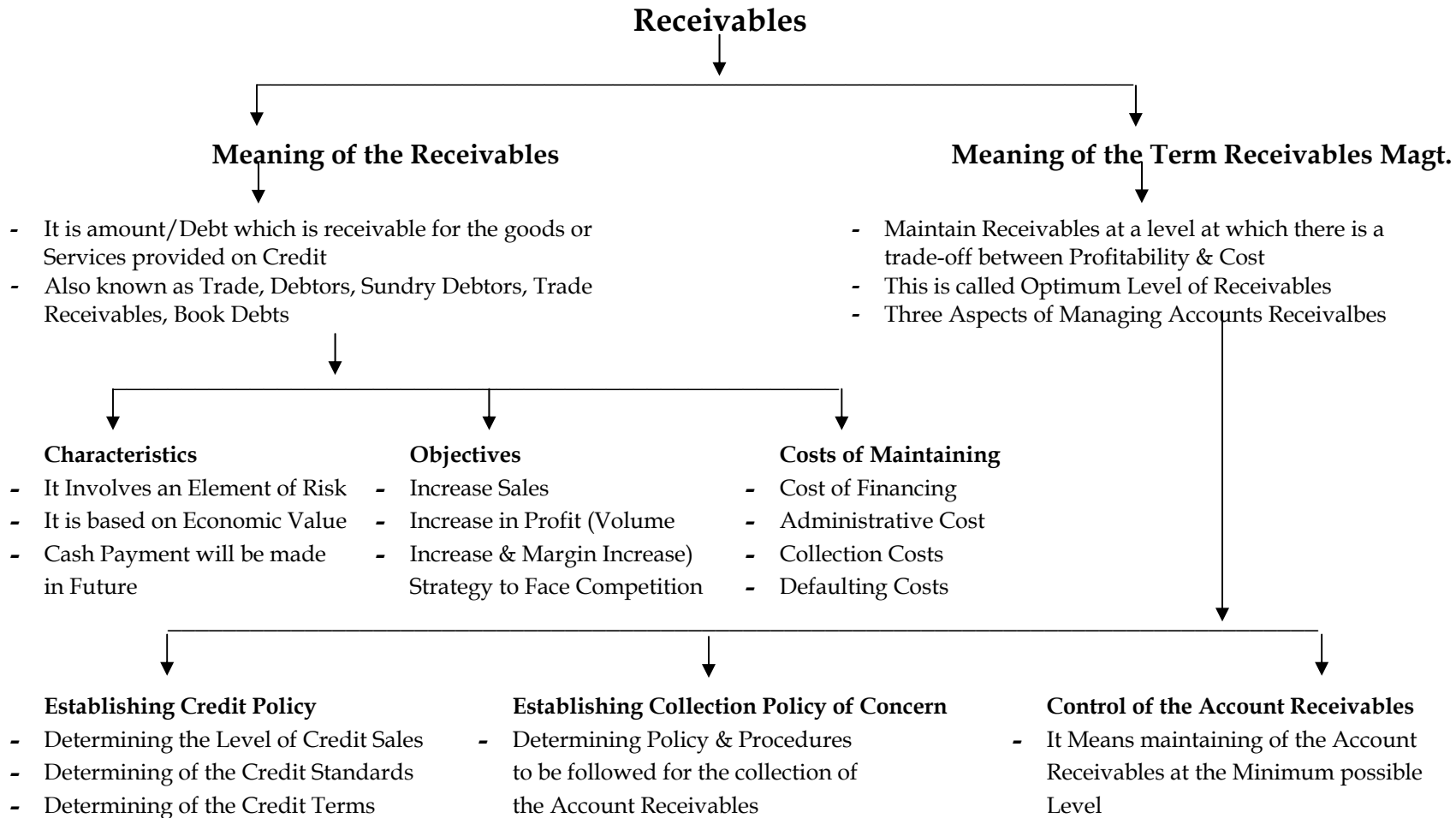
(vi) No stock-outs

(vii) Supply of the Goods is Satisfactory

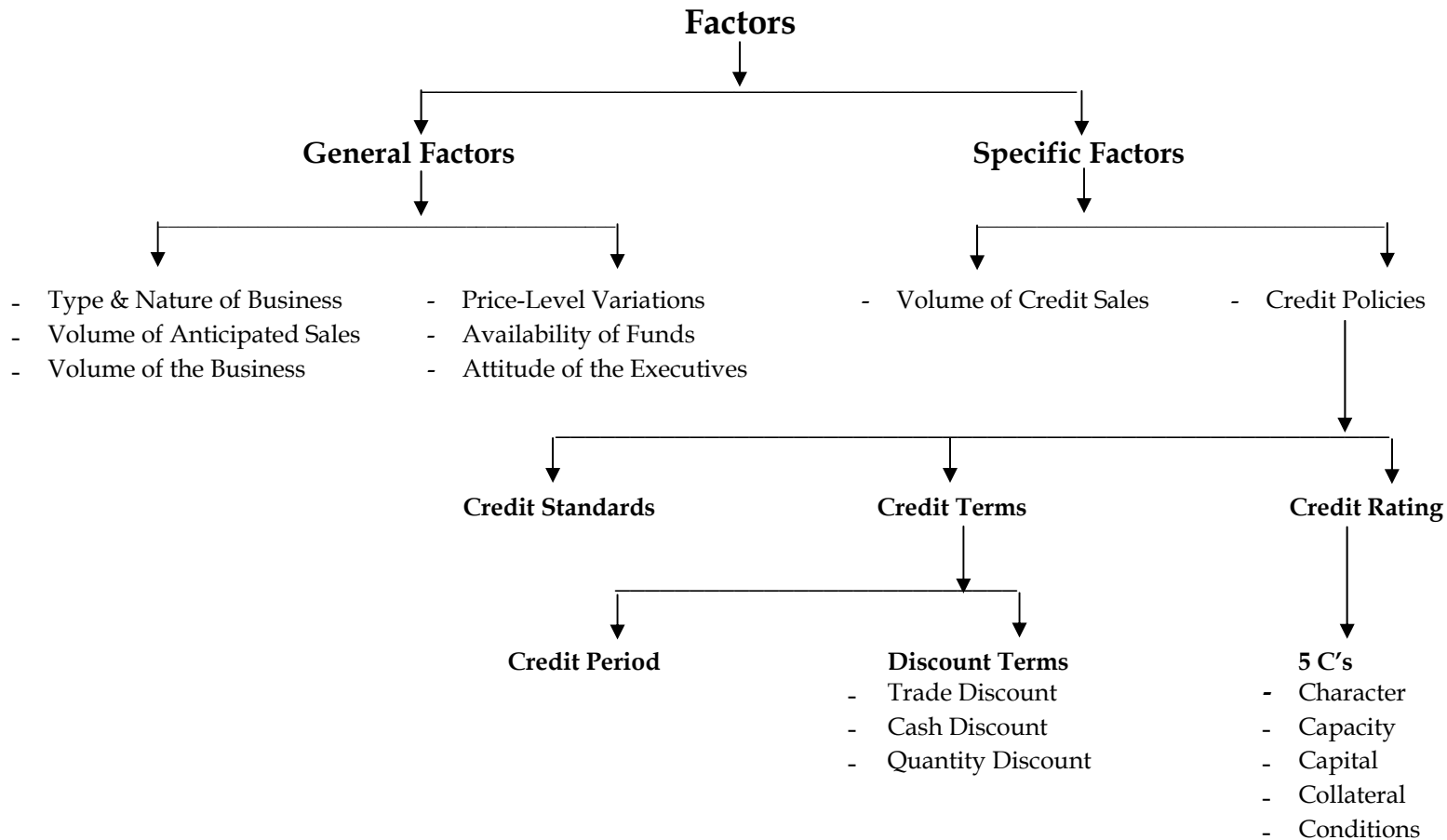
(viii) Prices of the goods are Stable

MANAGEMENT OF RECEIVABLES

1. Meaning of Receivables and Receivables Management:



2. Factors Determining Size of Investment in Receivables:



MANAGEMENT OF CASH

1. Meaning & Importance of Cash & Cash Management:

Cash & Cash Management

- **Cash** means Liquid Assets that a Business Owns. It includes Cheques, Money Orders & Bank Drafts
- **Cash Management** means efficient Collection & Disbursement of cash and any Temporary Investment of Cash
(Maintaining Optimum Level of Cash in an Organization is called Cash Management)

Objectives of Cash Management

- To meet Cash Disbursement as per Payment Schedule
- To meet Cash Collection as per Repayment Schedule
- To minimize funds locked up as Cash Balance by maintaining Optimum Cash Balance

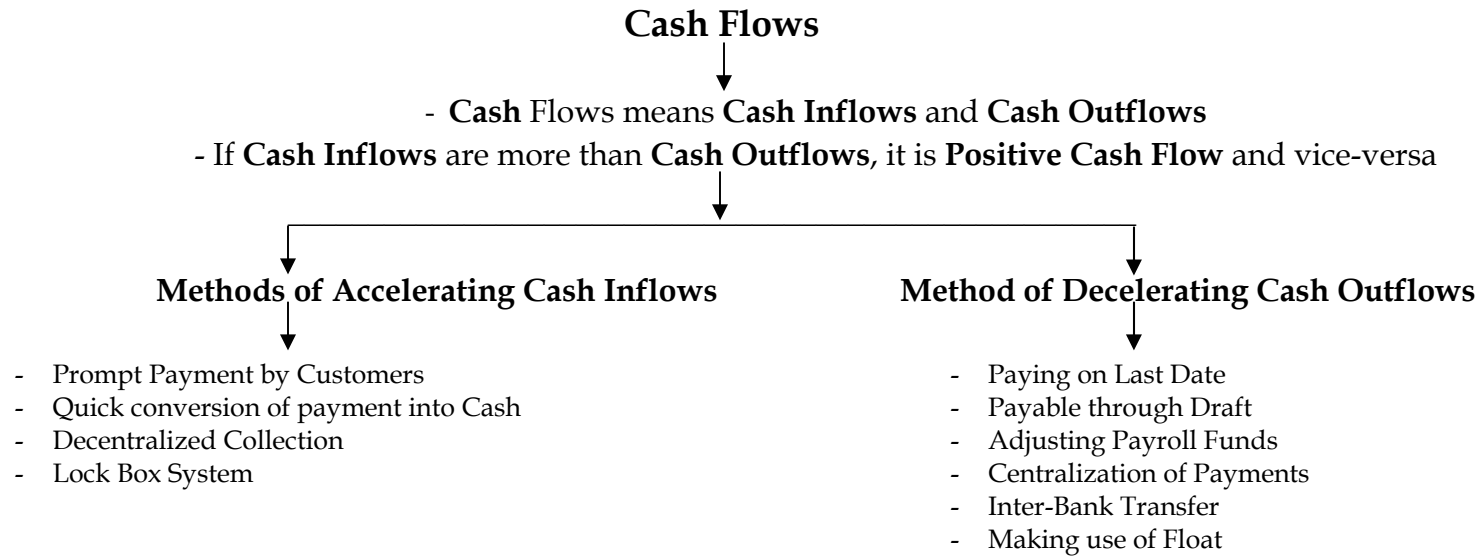
Motives of Holding Cash

- Transaction Motive
- Speculative Motive
- Precautionary Motive

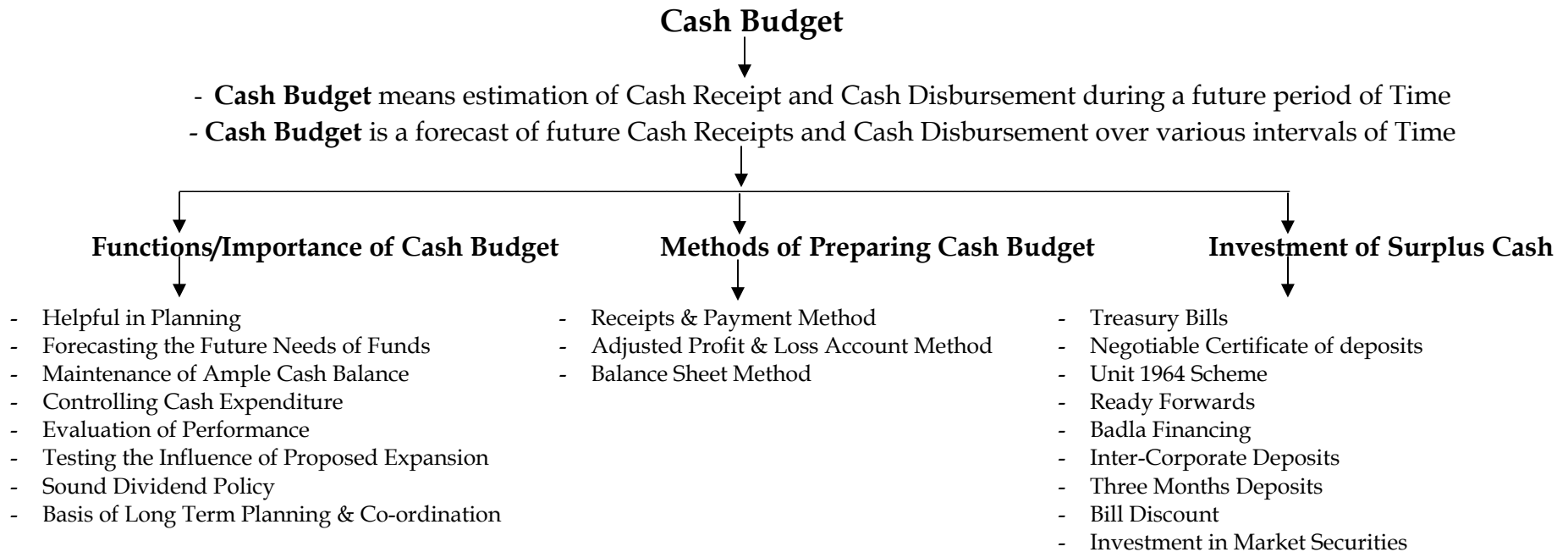
Importance of Cash Management

- Most Significant & Least Productive Asset
- Difficult to predict Cash Flows (Inflows & Outflows)
- Smallest Portion of Total Current Assets
- Cash Planning
- Cash Forecasting:
 - (a) Receipt & Disbursement Method
 - (b) Adjusted Net Income Method

2. Meaning of Cash Flows:

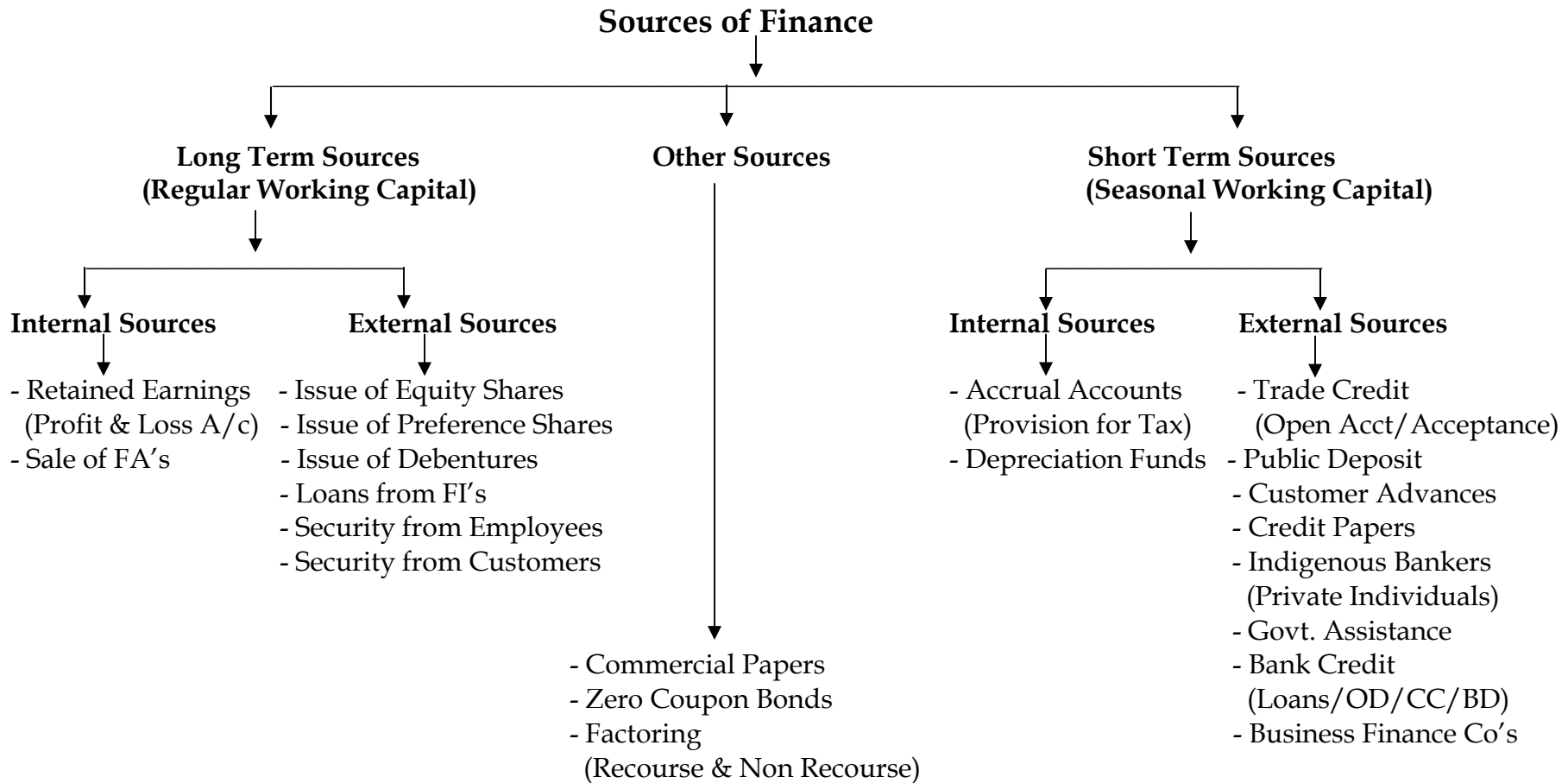


3. Meaning & Importance of Cash Budget:

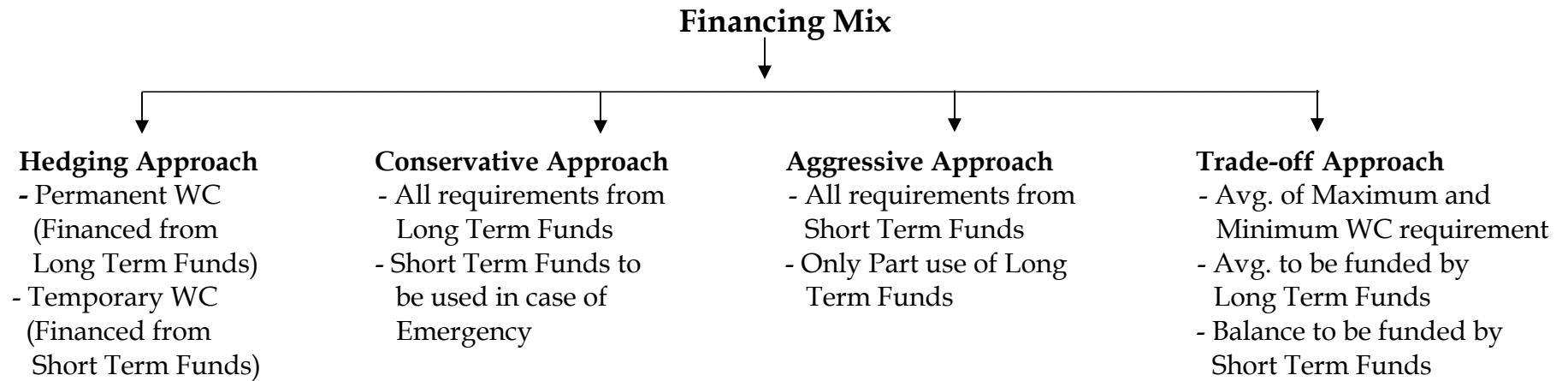


SOURCES OF WORKING CAPITAL FINANCE

1. Various Sources of securing Working Capital Finance:

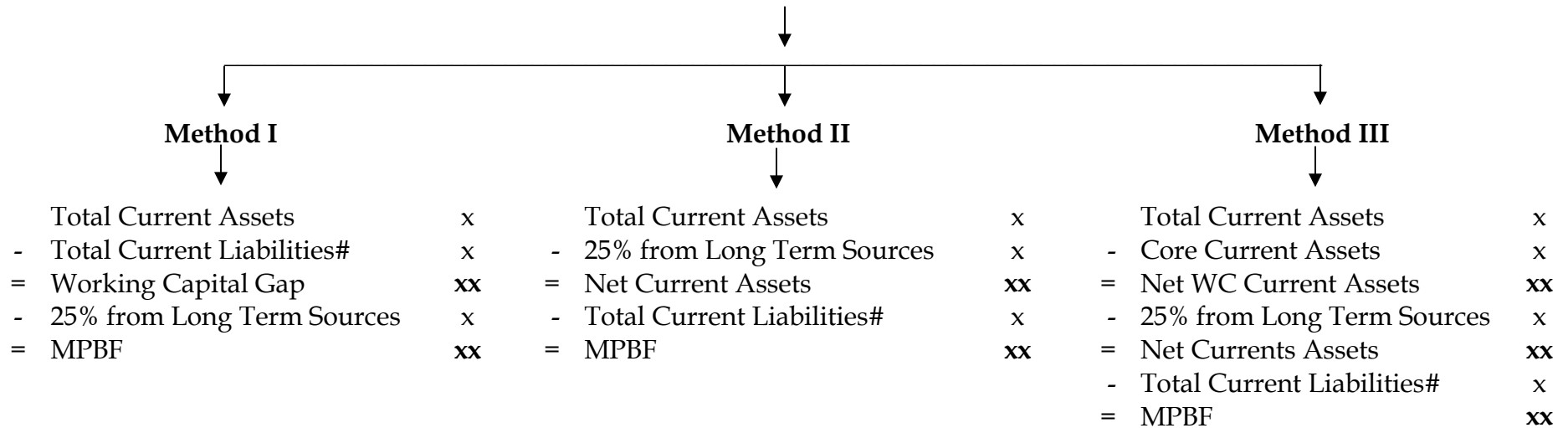


2. Approaches for Determining Financing Mix:



3. Maximum Permissible Bank Finance (Tandon Committee Recommendation):

MPBF Methods/Workings/Calculations



Note: Total Current Liabilities means Liabilities excluding Bank Borrowings to be taken into account for Calculation