Chapter -2 WORKING CAPITAL MANAGEMENT

- **MEANING OF WORKING CAPITAL (WC):** Working Capital refers to funds required to be invested in the business for a short period usually upto one year. Working Capital is the excess of Current Assets over Current Liabilities.

$$Working\ Capital = Current\ Assets - Current\ Liabilities$$

✓ It is also known as short-term capital or circulating capital.

- **PURPOSE OF WORKING CAPITAL:**
  - ✓ To meet day to day operating expenses.
  - ✓ For Effective utilization of Fixed Assets.
  - ✓ For holding stocks of raw materials, spare parts, consumables, work in progress and finished goods and book debts (i.e. debtors' balances and bills receivable).
  - ✓ Adequate WC determines short-term solvency of the firm.

❖ CONCEPTS OF WORKING CAPITAL

1. ***GROSS WORKING CAPITAL*:**

Thus,

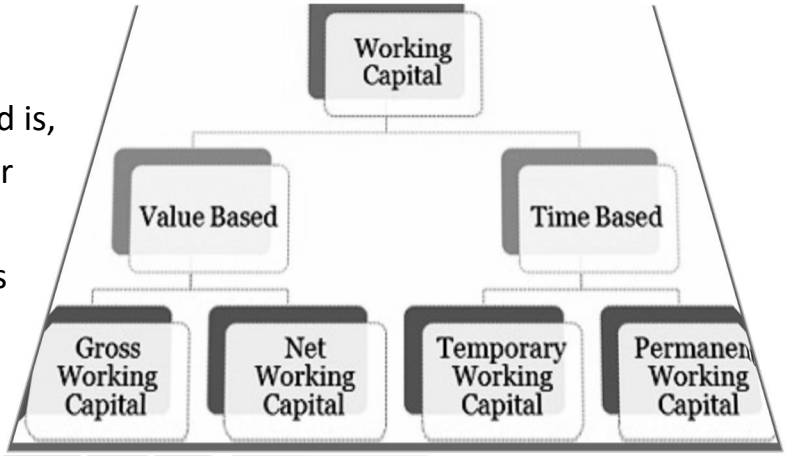
Gross Working Capital = **Total Current Assets**

Gross Working Capital = **Inventories**
i. Raw Materials
ii. Work-in-Progress
iii. Finished Goods
+ Cash
+ Short-Term Marketable Securities & Other Current Assets

2. ***NET WORKING CAPITAL*:**

Net Working Capital = **Gross Working Capital *Or* Current Assts** − **Current Liabilities**

3. ***PERMANENT WORKING CAPITAL*:** It refers to a certain minimum level of current assets, which is essential for the firm to carry on its business irrespective of the level of operations. This minimum level of investment in current assets is permanently locked up in business and is, therefore, referred to as permanent or ***fixed*** or ***hardcore*** working capital.

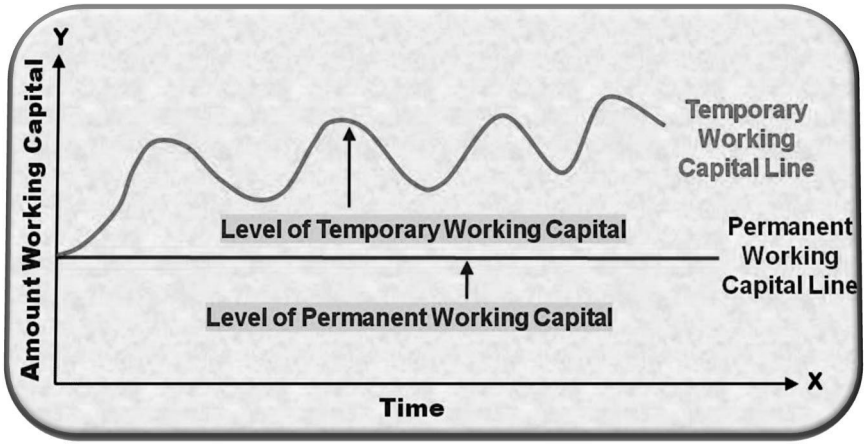


- ✓ It grows with the size of the business *i.e.* greater the size of the business, greater is the requirement of Permanent Working Capital.

4. ***TEMPORARY WORKING CAPITAL*:** It refers to the amount of working capital over and above the fixed minimum amount of working capital, which is required to meet seasonal and other temporary requirements. The amount of temporary working capital fluctuates depending upon the changes in the production and sales. It is also called ***fluctuating*** or ***variable*** or ***seasonal*** working capital.

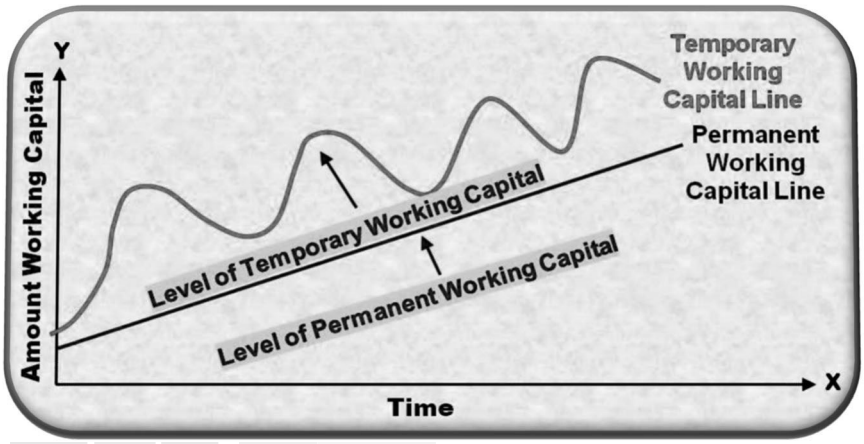
❖ WORKING CAPITAL IN CASE OF A STABLE FIRM

- ✓ Stable Firm is one which has reached that level of operation beyond which there are no or minimal opportunities of growth.
- ✓ In case of a stable firm, the permanent working capital is stable over time and takes the shape of a horizontal line while temporary working capital is fluctuating – sometimes increasing and sometimes decreasing.



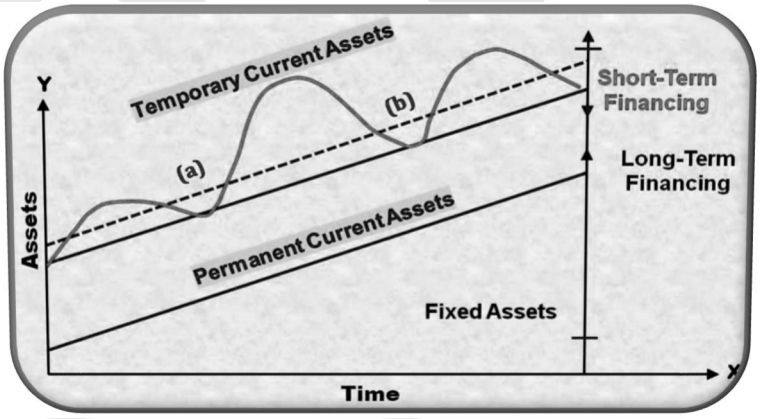
❖ WORKING CAPITAL IN CASE OF A GROWING FIRM

- ✓ Growing firm is the one which has ample opportunities of growth in the near future.
- ✓ In case of a growing firm, the permanent working capital may also keep on increasing over time to support a rising level of activity and hence permanent working capital line may not always be horizontal.

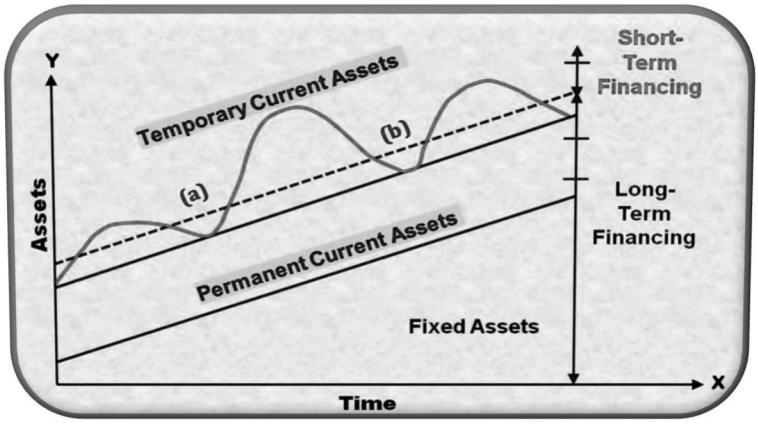


❖ APPROACHES TO WORKING CAPITAL MANGEMENT

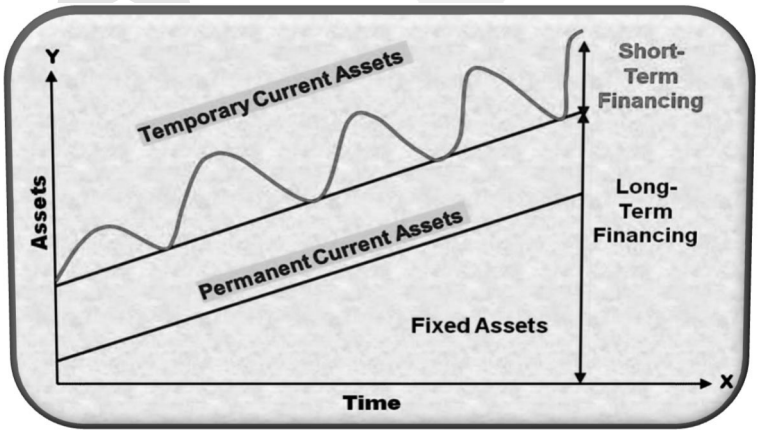
1. ***AGGRESSIVE APPROACH***: Under Aggressive Approach, all temporary current assets and some portion of permanent current assets are financed with short-term sources of funds and some portion of permanent current assets are financed with long-term sources of funds.



2. ***CONSERVATIVE APPROACH***: Under Conservative Approach, all permanent current assets and some portion of temporary current assets are financed with long-term sources of funds and some portion of temporary current assets are financed with short term sources of funds.



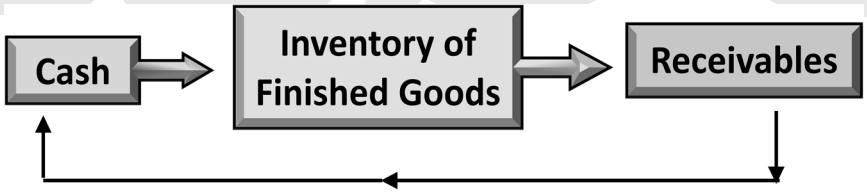
3. *MATCHING/HEDGING APPROACH*: Under Matching Approach, all permanent current assets are financed with long term sources of fund and all the temporary current assets are financed with short-term sources of funds.



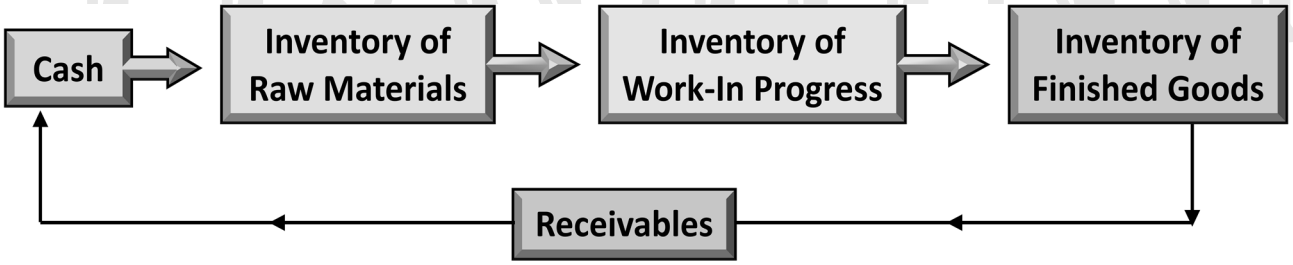
❖ NEED FOR WORKING CAPITAL

1) Working capital is needed because of the existence of operating cycle.
2) Operating cycle is the duration of time between acquisition of Raw Materials and the collection of cash from Receivables.
3) All the sales of the business do not convert into cash instantaneously.
4) There is always a time gap between the Sale of Goods and the Receipt of Cash from Debtors.
5) WC is required to meet various expenses related to manufacturing of goods during the above said time gap.
6) Basically, working capital is required to finance operations during operating cycle for the business to run smoothly.

❖ OPERATING CYCLE IN A TRADING FIRM



❖ OPERATING CYCLE IN A MANUFACTURING FIRM



Chapter -3 CASH MANAGEMENT

- Cash is the basic need for the smooth functioning of any business.
- Without proper Cash Management, even the most successful business may fail.

❖ CASH MANGEMENT

- **Cash Management** is the *process of Collecting and Managing the Cash Flows*.
- Cash Management can be important for both Individuals and Companies.
- In business, it is a key component of a company's financial stability.
- It provides answers to the following basic questions:
  a) How much to ***maintain Cash Balance***? It means *to plan how much of cash one should carry at any point of time*.
  b) How to ***finance Deficit***? *i.e. how to Compensate for Excess Cash Outflows over Cash Inflows*.
  c) How to ***invest Surplus***? *i.e. how to Utilize Excess Cash Inflows over Cash Outflows*.

➢ *OBJECTIVES of Cash Management:*

1. To avoid the situation of excessive and inadequate cash.
2. To determine and maintain the optimum level of cash after achieving a trade off between the profitability & liquidity so as to maximize the wealth of shareholders as a whole.
3. To determine minimum cash balance so as to meet any unexpected cash outflows.
4. To help in the prompt and timely action by the management in the situation of surplus or deficit cash.

❖ NEED FOR CASH

The following are the ***three principal motives for holding cash***:

1. ***Transaction Motive*:** The transaction motive is the need to hold cash to make routine payments while conducting business in the ordinary course. Example: To make payments for purchases, manufacturing expenses, office and selling expenses, taxes, etc.
2. ***Speculative Motive*:** The speculative motive is the need to hold cash in order to take advantage of profitable opportunities as and when they arise. Example: to make purchases for future requirements if it is expected that material prices will increase.
3. ***Precautionary Motive*:** The precautionary motive is the need to hold cash or marketable securities. Safety as is typified by the saying that a man has only three friends – an old wife, and old dog and money.

❖ CASH BUDGET

- ***MEANING of Cash Budget*:** Cash budget is a statement showing the estimated cash inflows, cash outflows and the resultant cash balances over a given budget period.
- ***PURPOSE of Cash Budget*:** Cash budget serves as a device for planning and controlling the inflows and outflows of cash to ensure the availability of cash when it is needed.

➢ METHODS OF CASH FORECASTING

1. Receipts and Payments Method
2. Adjusted Net Income Method

A. Receipts and Payments Method

The steps involved in preparation of cash budget as per Receipts and Payments Method are as follows:

PRACTICAL STEPS INVOLVED IN PREPARATION OF CASH BUDGET

***Step 1*:** Ascertain the Opening Balance

***Step 2*:** Identify, Analyse and Estimate the Cash inflows such as:

a) Operating Cash inflows (i.e., Cash inflows relating to operating activities such as cash sales, collection from debtors and trading commission).
b) Investing Cash inflows (i.e., Cash inflows relating to investing activities such as sale of investments, sale of fixed assets, interest and dividend on investments).
c) Financing Cash inflows (i.e., Cash inflows relating to financing activities such as proceeds from issue of shares, debentures).

***Step 3*:** Identify, Analyze, Estimate the Cash Outflows such as:

a) Operating Cash outflows (i.e., Cash outflows relating to operating activities such as cash purchases, payment to creditors, payment of operating expenses).
b) Investing Cash outflows (i.e., Cash outflows relating to investing activities such as purchases of investments, purchase of fixed assets).
c) Financing Cash outflows (i.e., Cash outflows relating to financing activities such as redemption of shares and debentures, payment of interest, tax and dividend).

***Step 4*:** Estimate the deficit or surplus & make the necessaryarrangement:

In case of deficit, the necessary arrangement (say by borrowing or by selling Marketable Securities) should be made to finance the deficit. In case of surplus, the necessary arrangement (say by Repayment of borrowing or by purchasing Marketable Securities) should be made to invest the surplus.

CASH BUDGET

For the Budget period ending----

Particulars	Period			
	April (₹)	May (₹)	June (₹)	July (₹)
A. Total Cash Available:	---	---	---	---
1. Opening Cash Balance	---	---	---	---
2. Cash Sales	---	---	---	---
3. Collection from Debtors	---	---	---	---
4. Proceeds from Issue of Shares/ Debentures	---	---	---	---
5. Proceeds from sale of Fixed Assets	---	---	---	---
6. Misc. Non-operating Income received	---	---	---	---
Total (1 + 2 + 3 + 4 + 5 + 6)	---	---	---	---
B. Total Cash Payments:	---	---	---	---
7. Cash Purchases of Material	---	---	---	---
8. Payments to Suppliers of Materials	---	---	---	---
9. Payment of Direct Labour Wages	---	---	---	---
10. Payment of Factory Overheads (Excluding Non-Cash Costs like Dep.)	---	---	---	---
11. Payment of Administration Expenses (Excluding Non-Cash Costs like Dep.)	---	---	---	---
12. Payment of Selling and Distribution Exp. (Excluding Non-Cash Costs like Dep.)	---	---	---	---
13. Redemption of Redeemable Pref. Share / Debentures / Buy Back of Shares	---	---	---	---
14. Payment for Purchase of Fixed Asset	---	---	---	---
15. Payment for Misc. Non-operating expenses	---	---	---	---
16. Advance payment of Income Tax	---	---	---	---
17. Payment of Dividend	---	---	---	---
Total (7 + ----- + 17)	---	---	---	---
18. **Surplus (Shortage) (A – B)**	---	---	---	---
19. **Effect of Short-term Financing & Investing:**	---	---	---	---
Proceeds of Short-term Borrowings	---	---	---	---
Proceeds of Marketable Securities	---	---	---	---
Less: Repayment of loan principal	(---)	(---)	(---)	(---)
Less: Repayment of Interest on loan	(---)	(---)	(---)	(---)
Less: Investment in Marketable Securities	(---)	(---)	(---)	(---)
20. **Closing Cash Balance (18 + 19)**	---	---	---	---