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The Analytical Study of Working Capital Management

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Abstract

The concept of working capital is, perhaps, one of the most misunderstood issues in the literature of finance. The reason is that it is subject to multiple connotations. From the accountants' perspective it refers to the current assets-current liabilities differential; from the finance managers' angle it implies the total investment made in current assets; from the production managers' view it refers to the total funds that a firm needs to carry out its day-to-day operations. For definitional purposes, this book adopts, for obvious reasons, the finance managers' view of working capital.

Key words:- Perspective, Investment, Operations, Definitional

Introduction

Traditionally, working capital has been defined as the firm's investment in current assets. Working capital decisions are of tremendous importance for any firm, as they affect the business's liquidity position. The principles underlying the management of working capital are both similar and dissimilar to those discussed in chapters 11, 12, and 13, on the management of long-term assets.

Like long-term investment decisions, working capital decisions require an evaluation of the benefits and costs associated with each component of current assets. Like long-term investment decisions, cash flows play an important role in working capital decisions as well.[1]

The primary difference between long-term decisions and working capital decisions relates to the time horizon of the decision-making. While long-term financial decisions have cash flow implications for a period that may extend up to 20 years, or even more, short-term financial decisions, i.e., working capital decisions typically affect the cash flows of the firm for a shorter time frame, extending up to a maximum of one year, normally. Unlike the case of long-term investment decisions, this makes the concepts of risk and time value of money less pertinent to working capital decision-making, as the value of money and the risk profile do not undergo any consequential change within a short time frame.

Instead, the concept of operating cycle and its management assumes significance in the context of working capital management (WCM). Firms have a greater degree of flexibility in working capital decisions, compared to long-term financial decisions, because working capital directly corresponds to sales. Chapters 21 to 24 look at various issues governing WCM.[2]

This chapter is introductory in nature, and looks at the principles underlying effective management and control of working capital. Chapters 22 to 24 discuss issues that are specific to the management of individual components of working capital-inventory, receivables, and cash.

Review of Literature

- **According to Nigam AK 2018-** Uncertainty in operating cycle Degree of uncertainty associated with supplies, availability of short-term credit at a short notice, etc affect the working capital decisions. Assured supplies reduce the uncertainty and thus do away with the need to block additional funds in current assets as a cushion to tide over supply constraints. Similarly, an easy access to short-term credit on convenient terms does away with the need for forcefully raising funds for a longer duration than required and unnecessarily blocking them in current assets to justify their utilization.

- **According to Joseph Andrew 2021-** Seasonality Seasonality of operations and the production policy of the firm has an impact on firm's working capital needs. A firm manufacturing and selling seasonal products such as air conditioners, sugar, etc., will witness large variations in its working capital requirements. There will be a surge in working capital investments during the peak season and a decline during the lean season. Similarly, firms with seasonal production policy will have

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a higher investment in working capital during the peak season, as compared to those following a steady production policy

- **According to Iyengar 2022-** Market conditions Prevailing and emerging market conditions also determine the level of working capital investments. Expansionary market conditions normally witness a growth in working capital requirements across the industry.Now let us take up the risk-return tradeoff that needs to be resolved in a given situation to decide the optimal level of current assets.

Objectives of the Study

- They can be used to match the timing of a firm's needs for short-term financing.
- This increases the interest cost the firm has to bear. This brings us to the second advantage, generally associated with the use of short-term financing.
- That this term structure reflects the rates of interest applicable to a given borrower at a particular point in time; thus. it would not describe the rates of interest available to another borrower or even those applicable to the same borrower at a different point in time.

Methodology

The financing of working capital is very crucial to management of working capital as it makes a significant impact on the firm's profitability and liquidity position. Theoretically, there can be three possible approaches to working capital financing: matching, conservative, and aggressive. The mix of short-term and long-term sources of working capital financing varies in each approach, and consequently, the impact of each of the three approaches on the profitability and liquidity position

The working capital financing policy may have a significant impact on the profitability-liquidity position of the firm. Theoretically, the policies of working capital financing can be categorized as: matching; conservative; and aggressive. of the business also varies.[3]

Data Analysis and Interpretation

The data has been gathered for share capital and working capital both are related for estimation purpose.[4]

What is the conservative approach of Share Capital and Working Capital

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Table-1.1

Respondents	Share Capital	Working Capital
Male	75	55
Female	25	45
Total	100	100

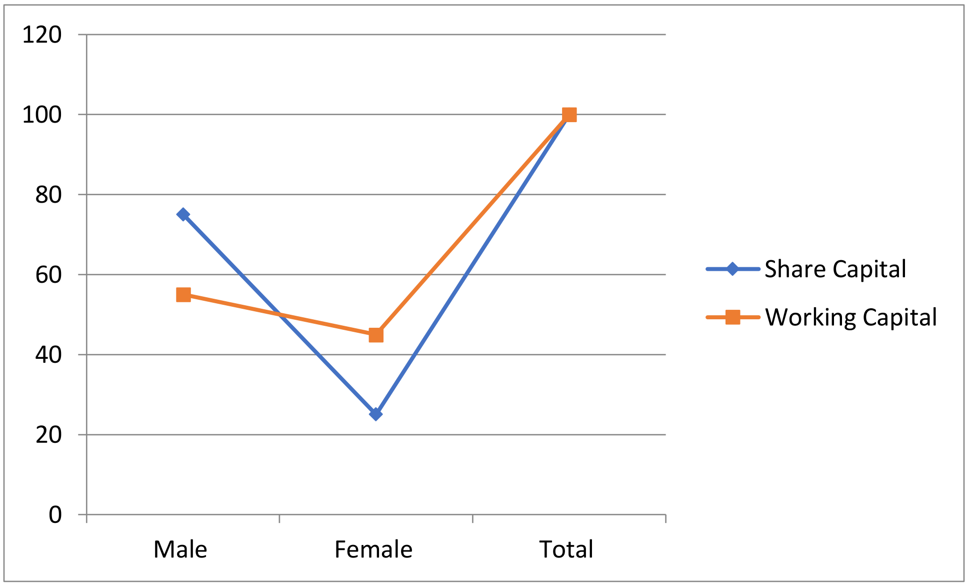

Table 1.1 Has displayed two respondents Male and Female Male has Share Capital 75 and Working Capital 55, Female Share Capital 25 and Working Capital 45 show it applied percentage method.

Findings of the Research

- To suggest guidelines for commercial bank to follow-up and supervise credit from the point of view of ensuring proper end-use of funds.[5]
- To make suggestions for prescribing inventory norms for different industries both in the private and public sectors and indicate the broad criteria for deviating from these norms.
- To make recommendations for obtaining periodical forecasts from borrowers of (a) business/production plans,

- To suggest criteria regarding satisfactory capital structure and sound financial basis in relation to borrowings.
- To make recommendations as to whether the existing pattern of financing working capital requirements by cash credit/overdraft system etc. requires to be modified. If so, to suggest suitable modifications.
- To make recommendations on any other related matter as the Group may consider germane to the subject of enquiry of any other allied matter which may be specifically referred to it by the Reserve Bank of India.

Conclusion

Aggressive approach to working capital financing favours maximum reliance on short-term sources for working capital financing. The working capital financing policy of a firm is said to be aggressive if it finances a part of its permanent working capital requirements from short-term sources.

Although the terminology matching, conservative, and aggressive may not be standard and universally applicable, the idea behind classifying the working capital financing policy of firms under these three broad categories is to make working capital financing policies across firms and over time comparable for the purposes of analysis and decision making. A firm may be more aggressive in its working capital financing vis-à-vis other firms in the sector, or compared with its own financing policy in the past.

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