**SES'S L.S.RAHEJA COLLEGE OF ARTS AND COMMERCE**

**Course: SYBA COMMERCE- IV(FINANCIAL MANAGEMENT) Unit: I(B)**
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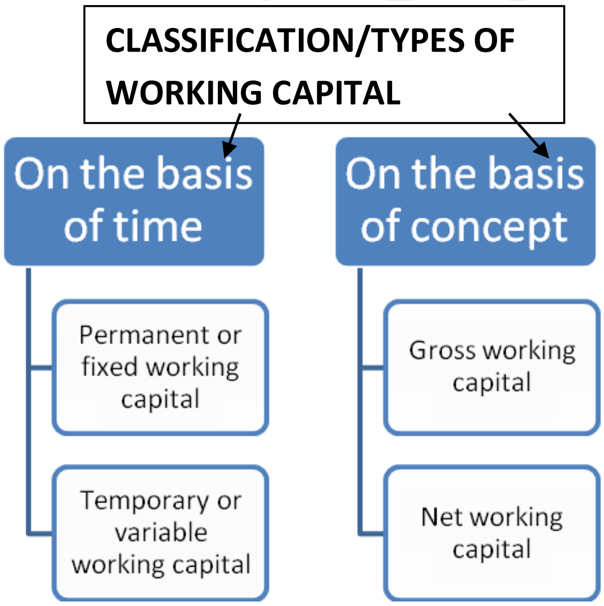
**S.Y.B.A –Commerce IV (Financial Management) Semester IV**

**DEFINATIONS OF WORKING CAPITAL**

1. In the words of Shubin, "Working capital is the amount of funds necessary to cover the cost of operating the enterprise."

2. According to Gesternberg, "Circulating capital means current assets of a company that are changed in the ordinary course of business from one form to another, as for example, from cash to inventories, inventories to receivables, receivables into cash."

**WORKING CAPITAL= CURRENT ASSETS- CURRENT LIABILITIES**




1. <u>PERMANENT OR FIXED WORKING CAPITAL</u>

This minimum level of current assets is called permanent or fixed working capital as this part of working is permanently blocked in current assets. As the business grow the requirements of working capital also increases due to increase in current assets.

2. TEMPORARY OR VARIABLE WORKING CAPITAL

Temporary or variable working capital is the amount of working capital which is required to meet the seasonal demands and some special exigencies. Variable working capital can further be classified as seasonal working capital and special working capital.

**IMPORTANCE OR ADVANTAGES OF ADEQUATE WORKING CAPITAL**

1. Solvency of the business
2. Goodwill
3. Easy Loans
4. Cash discounts
5. Regular supply of raw materials
6. Regular payment of salaries, wages and other day- to- day commitments
7. Exploitation of favourable market conditions
8. Ability to face crisis
9. Quick and regular return on investments
10. High Morale

## IMPORTANCE OR ADVANTAGES OF ADEQUATE WORKING CAPITAL

The main advantages of maintaining adequate amount of working capital are as follows:

1. **Solvency of the business**: - Adequate working capital helps in maintaining solvency of the business by providing uninterrupted flow of production.
2. **Goodwill**: - Sufficient working capital enables a business concern to make prompt payments and hence helps in creating and maintaining goodwill.
3. **Easy Loans**: - A concern having adequate working capital, high solvency and good credit standing can arrange loans from banks and others on easy and favourable terms.
4. **Cash discounts**: - Adequate working capital also enables a concern to avail cash discounts on the purchases and hence it reduces costs.
5. **Regular supply of raw materials**: - Sufficient working capital ensures regular supply of raw materials and continuous production.
6. **Regular payment of salaries, wages and other day- to- day commitments**:- A company which has ample working capital can make regular payment of salaries, wages and other day-to-day commitments which raises the moral of its employees, increases their efficiency, reduces wastages and costs and enhances production and profits.
7. **Exploitation of favourable market conditions**:- Only concerns with adequate working capital can exploit favourable market conditions such as purchasing its requirements in bulk when the prices are lower and by holding its inventories for higher prices.
8. **Ability to face crisis**: - Adequate working capital enables a concern to face business crisis in emergencies such as depression because during such period, generally, there is much pressure on working capital.
9. **Quick and regular return on investments**:- Every Investor wants a quick and regular return on his investments. Sufficiency of working capital enables a concern to pay quick and regular dividends to its investors as there may not be much pressure to plough back profits. This gains

the confidence of its investors and creates a favourable market to raise additional funds in the future.

10. **High Morale**: - Adequacy of working capital creates an environment of security, confidence, and high morale and creates overall efficiency in a business.

**FACTORS DETERMINING THE WORKING CAPITAL REQUIREMENTS**

1. Nature of Business
2. Size of Business
3. Production Policy
4. Length of Production Cycle
5. Seasonal Variations
6. Working Capital Cycle
7. Rate of Stock Turnover
8. Credit Policy
9. Business Cycles
10. Earning Capacity and Dividend Policy
11. Price Level Changes

## FACTORS DETERMINING THE WORKING CAPITAL REQUIREMENTS

The following are important factors generally influencing the working capital requirements.

1. **Nature or Character of Business**: - Public utility undertakings like Electricity, Water Supply and Railways need very limited working capital because they offer cash sales only and supply services, not products, and such no funds are tied up in inventories and receivables. On the other hand trading and financial firms required less investment in fixed assets but have to invest large amounts in current asset like inventories, receivables and cash; as such they need large amount of working capital.

2. **Size of Business/Scale of Operations**: - Greater the size of a business unit, generally larger will be the requirements of working capital. However, in some cases even a smaller concern may need more working capital due to high overhead charges, inefficient use of available resources and other economic disadvantages of small size.

3. **Production Policy**:- The production could be kept either steady by accumulating inventories during slack periods with a view to meet high demand during the peak season or the production could be curtailed during the slack season and increased during the peak season. If the policy is to keep production steady by accumulating inventories it will required higher working capital.

4. **Manufacturing Process/Length of Production Cycle**:- Longer the process period of manufacture, larger is the amount of working capital required.

5. **Seasonal Variations**:- In certain industries raw material is no available throughout the year. They have to buy raw materials in bulk during the seasons to ensure and uninterrupted flow and process them during the entire year.

6. **Working Capital Cycle**:- In a manufacturing concern, the working capital cycle starts with the purchase of raw material and ends with the realisation of cash from the sale of finished

products. The speed with which the working capital completes one cycle determines the requirements of working capital-longer the period of the cycle larger are the requirement of working capital.

7. **Rate of Stock Turnover**:-There is a high degree of inverse co-relationship between the quantum of working capital and the velocity or speed with which the sales are affected.

8. **Credit Policy**: - A concern that purchases its requirements on credit and sells its products/services on cash requires lesser amount of working capital. On the other hand a concern buying its requirements for cash and allowing credit to its customers, shall need larger amount of working capital as very huge amount of funds are bound to be tied up in debtors or bills receivables.

9. **Business Cycles**: - Business cycle refers to alternate expansion and contraction in general business activity. In a period of book i.e., when the business is prosperous, there is a need for larger amount of working capital due t increase in sales, rise in prices, optimistic expansion of business, etc.

10. **Earning Capacity and Dividend Policy**: - A firm that maintains a steady high rate of cash dividend irrespective of its generation of profits needs more working capital then the firm that retains larger part of its profits and does not pay so high rate of cash dividend.