

# Working Capital Management

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# Syllabus: Management of Working Capital

- Introduction
- Operating Cycle Concept
- Estimation of Working Capital requirement
- Financing of Working Capital
  - Various Approach
  - Norms of Banks

# Management of Working Capital

## Management of Net Working Capital

Manage  
ment of  
Debtors

Manage  
ment of  
Stock

Manage  
ment of  
Cash

Manage  
ment of  
Payable

## Financing of Working Capital

# Plan of Study

- Introduction
  - Concept of Working Capital
  - Concept of Working Capital Management
- Management of Working Capital
  - Estimation of Working Capital requirement
  - Operating Cycle Concept
  - Management of components of Working Capital
    - Debtor Management or Receivable management
    - Inventory Management or Management of Stock
    - Cash Management or Short term asset management
    - Payable management or creditors management
- Financing of Working Capital
  - Various Approach
  - Norms of Banks

# Introduction

- A business requires two types of investment (i) investment in fixed assets which offers fixed facility and (ii) investment in current assets which helps in maintaining day-today activities
- The capital of a business which is used in its day-to-day operation is called working capital

# Two Concepts of Management

- Depending upon the context, working capital management may be gross working capital management or net working capital management

More specifically,

- Gross Working Capital = Total Current Assets
- Net Working Capital = Net Current Asset  
= Total Current Asset - Total Current Liability

# Introduction: Working Capital Management

- Grossly management of current assets is management of working capital
- Strictly speaking management of net current asset (over current liability) is managing working capital

As generally the current assets are more controllable than current liabilities, management of working capital is basically management of current assets

# What is Current Asset?

Current asset: An asset that (a) should be normally realised within 1 year and (b) is primarily held to facilitate trading activities of the business and to meet urgent fund requirement is called current asset.



# Components of Current Assets

- Inventory
  - Raw Material
  - Work-in-progress
  - Finished Goods
- Receivables
  - Trade Receivables
  - Bill Receivable
- Cash & Bank
  - Cash in hand
  - Cash at Bank
  - Short term securities
- Prepaid Expenses

# Components of Current Liability

A liability is current one if the liability is expected to be settled within 1 year and is held primarily to facilitate its business operation

# Components of Current Liability

- Outstanding Payments
  - Outstanding Wages & Salary
  - Outstanding expenses
- Payable
  - Sundry Creditors
  - Trade Payable

# Nature of Management of Working Capital

As current asset is much more controllable than current liability, working capital management is basically management of current assets.

Again, working capital can be managed in two dimensions:

- (a) On the basis of total amount (How much?)
- (b) On the basis of duration (How long?)

# Objective of Working Capital Management

The objective can be discussed from two dimensions:

On the basis of value: The cash is realised from components of working capital where as cash is required to be paid for meeting up current liabilities within a specified period. Thus, enough current assets should be kept in the business to met current liability for smooth functioning of the business.

One objective of the working capital management to ensure adequate total working capital and also ensuring adequate amount of all components of working capital

# Objective of Working Capital Management

- On the basis of duration: There could be two types of working capital: (a) permanent working capital (b) temporary working capital

The requirement of working capital is fluctuating . When a company is scheduled to produce and sell more, it requires more working capital. On the hand, if the company estimate lower sale and decide to lower its production, it scales down the amount of working capital.

The above analysis suggests, there is one permanent portion of working capital which may be required throughout the year. However, depending upon requirement a temporary portion may also be required over and above permanent working capital.

# An Illustration

- The average fixed assets of a business concern is Rs. 7,50,000. Following is the conversion time:

From Raw material to WIP: 3 weeks

From WIP to Finished Goods: 2 weeks

From Finished Goods to Cash Sale: 2 weeks

If finished goods to cash cycle reduces to 1 week. Whether working capital cost would reduce or remain equal?

# Questions

- 1. Define (a) Current Asset (b) Current Liability (c) Net Current Assets (d) Gross Working Capital (e) Working Capital
- 2. What is the objective of working capital management?
- 3. How amount of working capital components and also their duration or time before conversion is important for working capital management?
- 4. Why working capital management is basically management of current assets?