

## UNIT - 5

### 1. Working Capital Management:

#### Meaning of Working Capital:

Working capital is the amount of funds required for meeting day-to-day expenses of the business.

#### Definition of working capital:

ICAI: "Working capital means the funds available for day-to-day operations of an enterprise."

#### Concepts of working capital:

##### 1. Gross Concept:

According to this concept, the term working capital refers to the amount of funds invested in current assets that are employed in the firm. The gross concept is also known as "current-capital" or "circulating capital". This concept is ~~sometimes preferred due to the~~

##### 2. Net Concept:

According to this concept working capital is the excess of current assets over current liabilities or  
$$\text{Net working capital} = \text{Current Assets} - \text{Current Liabilities.}$$



## Types of working capital.

1. Permanent working capital: It is the amount of fund which is required to produce goods and services necessary to satisfy demand at its lowest point. It is further divided into two types,

- (i) Regular working capital.
- (ii) Reserve margin.

2. Temporary working capital;

It presents working capital requirements over and above permanent working capital and is dependent on factors like peak season, trade cycle, boom etc. It is also divided into two types; ~~are~~

- (i) Seasonal working capital
- (ii) Special working capital.

## Working capital Management:

It is best described as the administration of all aspects of current assets and current liabilities. It is concerned with the problems that arise in the management of current assets and current liabilities.



## Forecasting the working capital requirements:

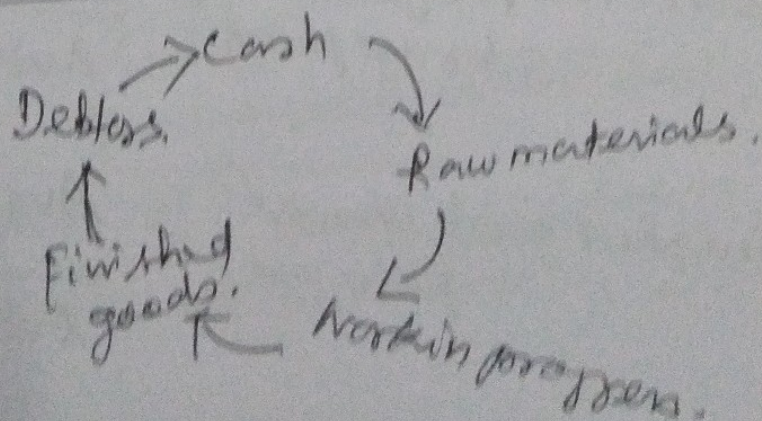
There are two methods to calculate the working capital requirements, they are;

### 1. operating cycle method:

It is based on the concept of operating cycle. When goods are sold on credit is the normal practice of business firms today to cope with increased competition these sale of goods cannot be converted into cash instantly, due to time lag between sales and realisation of cash.

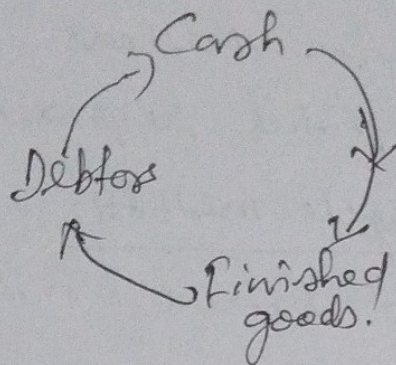
The operating cycle is the length of time required for conversion of non-cash assets into cash. This includes the conversion of cash into raw materials, raw materials into work in progress, work in progress into finished goods, finished goods into receivables, receivables into cash, and this cycle repeats is known as operating cycle.

### operating cycle of manufacturing firm.





operating cycle of trading firm.



Computation of operating cycles:

	<u>Days.</u>
Raw materials storage period	xxx
Add: Work-in-progress holding period	xxx
Finished goods storage period	xxx
Debtors collected period	xxx
	<hr/>
	xxx
Less: Creditors payment period	xxx
	<hr/>
Operating cycle period	xxx

(i) Raw material storage period } =  $\frac{\text{Ave. stock of raw materials}}{\text{Ave. cost of materials consumed per day} \times 365}$

(ii) Work-in-progress storage period } =  $\frac{\text{Ave. stock of WIP}}{\text{Ave. cost of production per day} \times 365}$

(iii) Finished goods storage period } =  $\frac{\text{Ave. stock of finished goods}}{\text{Ave. cost of goods sold per day} \times 365}$



$$(iv) \text{ Debtors collection period} = \frac{\text{Ave. account receivable}}{\frac{\text{Ave. credit sales} \times 365}{\text{per day}}}$$

$$(v) \text{ Creditors payment period} = \frac{\text{Ave. accounts payable}}{\frac{\text{Ave. credit purchases} \times 365}{\text{per day}}}$$

Working capital requirement =

$$= \frac{\text{Total operating expenditure in the year}}{\text{No. of operating cycles in a year.}}$$

## 2. Estimation of components of working capital method:

Steps to calculate working capital requirement under this method:

### 1. Estimation of current assets:

(i) estimation of stock of Raw materials

(ii) estimation of stock of work-in-progress

(iii) estimation of stock of finished goods.

(iv) Trade debtors.

### 2. Estimation of current liabilities:

(i) estimation of Trade creditors

(ii) estimation of outstanding expenses.



Computation of working capital required:

Statement Showing working  
Capital Requirement.

Current Assets:

(i) <u>Stock:</u> Raw materials	xxx	
work-in-progress:		
Raw materials	xx	
Labour	xx	
overheads	xx	xxx
Finished goods	xxx	xxx
		xxx
(ii) Trade Debtors:		xxx
(iii) Cash balance		xxx

Less: Current Liabilities:

Trade creditors	xxx	
outstanding wages	xxx	
outstanding overheads	xxx	xxx
		xxx
Net-working capital (CA-CL)		xxx
<u>Add: Contingencies</u>		xxx
Working Capital		xxx



## Cash Management:

Cash management is a broad term that refers to the collection, concentration and disbursement of cash. Managing cash flows is the most important function of the financial manager.

## Cash Budget:

A cash budget shows cash inflows and outflows expected in a budget period, and net effect of these flows on cash balances. It enables management to obtain a preview of the cash position of the firm.

## Methods of preparing cash Budgets.

### 1. Receipts and payments method.

This is the most simple & popular method. It is useful to preparing short-term cash budgets.

### 2. Adjusted Profit & Loss method:

This method is mostly used to long-term cash budgets, and it provides lesser details than the receipts and payments method.

### 3. Balance sheet method:

This method is also useful to prepare long term cash budgets. Under this method a budgeted balance sheets are prepared for some future periods.



Formal- for Cash Budget (short-term)

Cash Budget- for three months ended  
30th June 2009

Particulars	April	May	June
Estimated opening balance of cash	xxx	xxx	xxx
<u>Add: Estimated cash Receipts:</u>			
cash sales	xxx	xxx	xxx
collection from debtors	xx	xx	xx
Sale of assets	xx	xx	xx
Dividends	xx	xx	xx
Interest on loans	xx	xx	xx
Other receipts	xx	xx	xx
Total Receipts (A)	xxx	xxx	xxx
<u>Less: Estimated cash payments:</u>			
Cash purchases	xxx	xxx	xxx
payments to creditors	xxx	xxx	xxx
Payment of expenses	xxx	xxx	xxx
purchase of fixed assets	xxx	xxx	xxx
Other payments	xxx	xxx	xxx
Dividends paid	xxx	xxx	xxx
Tax paid	xxx	xxx	xxx
Total payments (B)	xxx	xxx	xxx
Estimated Cash balance at the end (A-B)	xxx	xxx	xxx