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A STUDY ON IMPORTANCE OF WORKING CAPITAL MANAGEMENT ON FIRMS' PERFORMANCE

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Abstract—*Decisions with reference to capital involve managing relationships between a firm's short assets and liabilities to make sure a firm is in a position to continue its operations, and have sufficient money flows to satisfy each maturing short debts and future operational expenses at lowest prices, increasing firm's gain. The capitals noticeably go along with the operative cycle. A poring over of the operative cycle reveals that funds endowed within the operation area unit recycled back in to money. The shorter the amount of operative cycle the larger are going to be the turnover of the funds endowed in varied functions. The shorter amount of operative cycle shows higher potency of a firm. The potency of assets management is often determined by the in-operation cycle of the firm. This paper aims at analyzing the potency of assets management through the connection between in operation cycle amount and profitableness of Cipla Ltd. To measure the capital Management potency, operative cycle has been calculated and therefore the relationship is formed with margin quantitative relation.*

Keywords—*Capital, Management, Operative Cycle, Price, Working Capital.*

INTRODUCTION

The business capital operating on day-by-day operations current assets over the current liabilities the differentiate amount is called working capital. Working capital also called as operating asset.

WC=Current Asset-Current Liabilities

CONCEPTS OF WORKING CAPITAL

According to the real process of working capital, we can say working capital is the capital you require for the working for example, functioning of your business in the short run. There are two possible interpretations of working capital concept:

- Gross working capital- refers to the firm's investment in the current assets and includes cash, short term securities, debtors, bills receivables and inventories.

It is necessary to concentrate on the fact that the investment in the current assets should be neither excessive nor inadequate.

- Net working capital- generally refers to the difference between the current assets and the current liabilities.
- Current liabilities are those claims of outsiders, which are expected to mature for the payment within an accounting year include creditors, bills payable, bank overdraft and outstanding expenses.
- When current assets exceed current liabilities, it is called positive working capital and when current liabilities exceed current assets it is called negative working capital.

FACTORS AFFECTING WORKING CAPITAL

- Nature of business
- Production Policy
- Credit policy
- Inventory policy
- Abnormal factor
- Market conditions
- Conditions of supply
- Business cycle
- Taxation policy
- Dividend policy
- Operating efficiency
- Price level changes
- Depreciation policy
- Availability of raw material

HOW MUCH WC IS NEEDED?

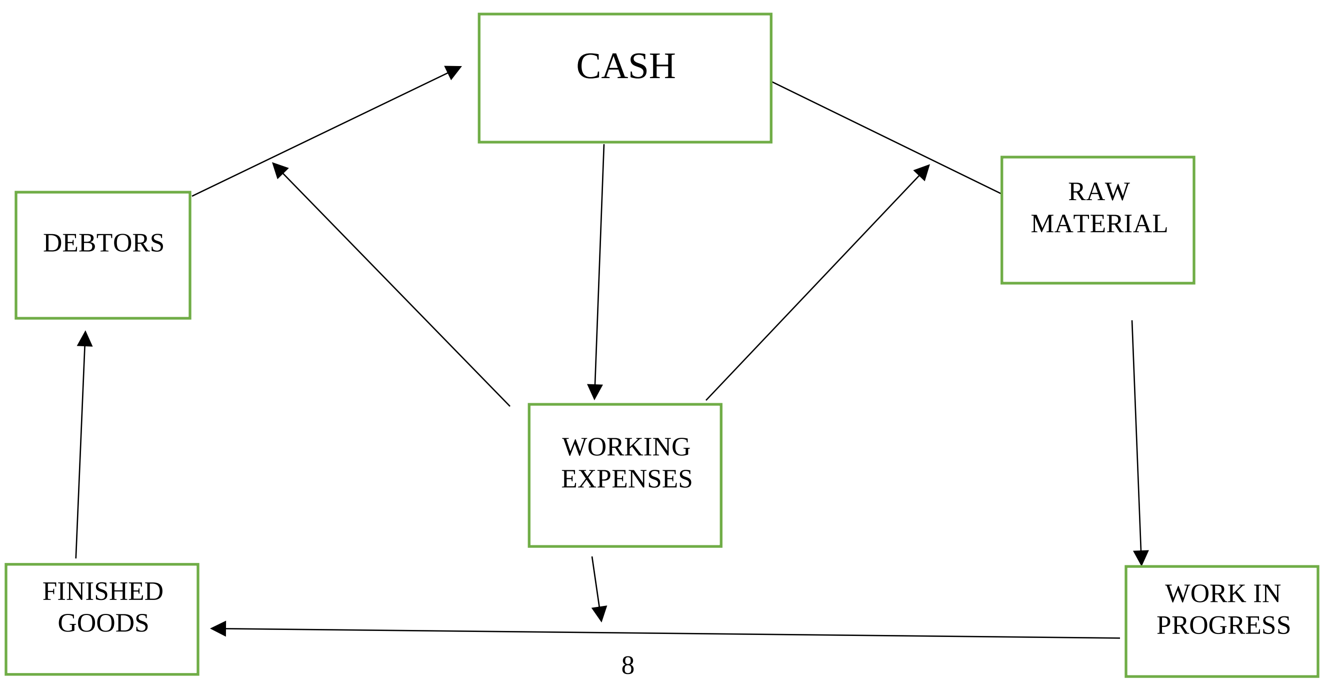
It depends on the following factors –

- Size of the firm
- Activities of the firm
- Availability of credits
- Attitudes towards profit
- Attitude toward risks
- Others

OBJECTIVE OF WORKING CAPITAL MANAGEMENT

As already mentioned above, basically, the main purpose of working capital management is to manage the firm's current assets and liabilities in such a way that a satisfactory level of working capital is maintained. From this point of view, it can be clearly seen that the interaction between current assets and current liabilities is, therefore the main theme of the theory of the working capital management.

WORKING CAPITAL CYCLE



1. Nature of Enterprise

The nature and the working capital requirements of an enterprise are interlinked. While a manufacturing industry has a long cycle of operation of the working capital, the same would be short in an enterprise involved in providing services. The amount required also varies as per the nature; an enterprise involved in production would require more working capital than a service sector enterprise.

2. Manufacturing/Production Policy

Each enterprise in the manufacturing sector has its own production policy, some follow the policy of uniform production even if the demand varies from time to time, and others may follow the principle of 'demand-based production' in which production is based on the demand during that particular phase of time. Accordingly, the working capital requirements vary for both of them.

3. Operations

The requirement of working capital fluctuates for seasonal business. The working capital needs of such businesses may increase considerably during the busy season and decrease during the slack season. Ice creams and cold drinks have a great demand during summers, while in winters the sales are negligible.

4. Market Condition

If there is high competition in the chosen product category, then one shall need to offer sops like credit, immediate delivery of goods etc. for which the working capital requirement will be high. Otherwise, if there is no competition or less competition in the market then the working capital requirements will be low.

5. Availability of Raw Material

If raw material is readily available then one need not maintain a large stock of the same, thereby reducing the working capital investment in raw material stock. On the other hand, if raw material is not readily available then a large inventory/stock needs to be maintained, thereby calling for substantial investment in the same.

6. Growth and Expansion

Growth and expansion in the volume of business results in enhancement of the working capital requirement. As business grows and expands, it needs a larger amount of working capital. Normally, the need for increased working capital funds precedes growth in business activities.

7. Price Level Changes

Generally, rising price level requires a higher investment in the working capital. With increasing prices, the same level of current assets needs enhanced investment.

8. Manufacturing Cycle

The manufacturing cycle starts with the purchase of raw material and is completed with the production of finished goods. If the manufacturing cycle involves a longer period, the need for working capital would be more.

VARIOUS COMPONENTS OF OPERATING CYCLE

It may be calculated as follows:

$$\text{A) Raw material shortage period} = \frac{\text{Average stock of raw material}}{\text{Average cost of raw material Consumed per day}}$$

$$\text{B) WIP holding period} = \frac{\text{Average WIP inventory}}{\text{Average cost of production per day}}$$

C) Finished goods storage period =

Estimated production (in units) * direct lab permit

12 months / 360 days

OR

Average stock of finished goods

Average cost of goods sold per day

D) Debtors collection period =

Average goods debtors

Average credit sale per day

E) Credit period available to suppliers =

Average rate credit

Average credit purchase per day

WORKING CAPITAL POLICY / APPROACHES

It can be explained by two approaches:

- Conservative approach
- Aggressive approach

Conservative approach:

A firm financing its common permanent assets & also with long term

Financing &Less risky so far as insolvency is concerned. However, funds may be invested in such investment which fetches small returns to build up liquidity.

Aggressive approach:

The firm uses only short term financing in this approach, the firm

Finances a part of the permanent assets with short term financing. This approach refers to riskier but may at returns to the assets

FINANCING OF WORKING CAPITAL

Financing of working capital can be done in two ways:

- Long term sources
- Short term sources

A. Long term sources

1. Share capital

a. Equity share capital

b. Preference share capital

2. Debentures

a. Convertible debentures

b. Non -convertible debentures

c. Redeemable debentures

d. Non-Redeemable debentures

3. Bonds

4. Loans from banks & financial institutions

5. Retained earnings

6. Venture capital fund for innovative projects

B. Short term sources

1. Bank credit

2. Transaction credit

3. Advances from customers

4. Bank advances

5. Loans

6. Overdraft

7. Bills purchase and discounted

8. Advance against documents of title of goods

9. Term loans by bank

10. Commercial paper

11. Bank deposits

CONSEQUENCES OF UNDER ASSESSMENT OF WORKING CAPITAL

- Growth may be stunted. It may become difficult for the enterprise to undertake profitable projects due to non-availability of working capital.
- Implementation of operating plans may become difficult and consequently the profit goals may not be achieved.
- Cash crisis may emerge due to paucity of working funds.
- Optimum capacity utilization of fixed assets may not be achieved due to non-availability of the working capital.
- The business may fail to honor its commitment in time, thereby Adversely affecting its credibility. This situation may lead to business Closure.
- The business may be compelled to buy raw materials on credit and sell finished goods on cash. In the process, it may end up with increasing cost of purchases and reducing selling prices by offering discounts. Both these situations would affect profitability adversely.
- Non-availability of stocks due to non-availability of funds may result in production stoppage.
- While underassessment of working capital has disastrous implications on business, over assessment of working capital also has its own dangers.

FINANCING WORKING CAPITAL

Now let us understand the means to finance the working capital. Working capital or current assets are those assets, which unlike fixed assets change their forms rapidly. Due to this nature, they need to be financed through short-term funds. Short-term funds are also called current liabilities. The following are the major sources of raising short-term funds:

1. Supplier's Credit

At times, business gets raw material on credit from the suppliers. The cost of raw material is paid after some time, i.e. upon completion of the credit period. Thus, without having an outflow of cash the business is in a position to use raw material and continue the activities. The credit given by the suppliers of raw materials is for a short period and is considered current liabilities. These funds should be used for creating current assets like stock of raw material, work in process, finished goods, etc.

2. Bank Loan for Working Capital

This is a major source for raising short-term funds. Banks extend loans to businesses to help them create necessary current assets so as to achieve the required business level. The loans are available for creating the following current assets:

- Stock of Raw Materials
- Stock of Work in Process
- Stock of Finished Goods
- Debtors

Banks give short-term loans against these assets, keeping some security margin. The advances given by banks against current assets are short-term in nature and banks have the right to ask for immediate repayment if they consider doing so. Thus, bank loans for creation of current assets are also current Liabilities.

iii. Promoter's Fund

It is advisable to finance a portion of current assets from the promoter's funds. They are long-term funds and, therefore do not require immediate repayment. These funds increase the liquidity of the business.

CONCLUSION

To sum up, I want to note that working capital occupies a peculiar position in the Capital structure of a firm. It is the life-blood of all types of enterprises, manufacturing and trading both. If the business has enough working capital, it can maintain its operating efficiency. Not only that, but adequate working capital provides psychological satisfaction and relief to the management. Only those enterprises, which have adequate working capital, can survive in times of depression. It has been observed that number of business enterprises have failed due to inefficient management of working capital. Form this point of view, the management of working capital becomes a tedious exercise for a financial manager of a firm. The most important point of that, working capital management is not only for big companies it is also quite important for small firm.

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