A Study on Working Capital Management

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Abstract: **The process of managing activities and processes related to working capital. This level of management serves as a check and balances system to ensure that the amount of cash flowing into the business is enough to sustain the company's operations. In this paper, our aim is to study about Working Capital Management, Types of working capital, The Working Capital Cycle. Working capital management involves the relationship between a firm's short-term assets and its short-term liabilities. The goal of working capital management is to ensure that a firm is able to continue its operations and that it has sufficient ability to satisfy both maturing short-term debt and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable and payable, and cash**.

I. INTRODUCTION

An accounting strategy in which a company seeks to maximize its cash flows so as to pay for its current liabilities and operating expenses. Examples of working capital management include active monitoring of accounts receivable and maintaining little short-term debt. Working capital management, if done properly, can help a company improve its earnings and maintain a healthy financial state.(a)

A positive working capital cycle balances incoming and outgoing payments to minimize net working capital and maximize free cash flow. For example, a company that pays its suppliers in 30 days but takes 60 days to collect its receivables has a working capital cycle of 30 days. This 30 day cycle usually needs to be funded through a bank operating line, and the interest on this financing is a carrying cost that reduces the company's profitability. Working capital of a company is one of the most important measures in any financial statement that is also easy to calculate. It is a reflection of the current financial condition of a company that enables investors to know about the health (financial) of a company. However, there are two terms called gross working capital and net working capital that are also used commonly. People remain confused between these two as they cannot differentiate between them. This article will threadbare these two concepts to remove any doubts from those who are interested in the health of a company.

II. TYPES OF WORKING CAPITAL

Working Capital is divided into various types based balance sheet view and operating cycle view. Balance sheet view divides working capital into gross working capital and net working capital and the operating cycle view divides the working capital into permanent and temporary working capital. Permanent working capital is further divided into seasonal and special working capital whereas temporary working capital into regular and reserve working capital.

A. Gross Working Capital (GWC): Current assets in the balance sheet of a company are known as gross working capital. Current assets are those short term assets which can be converted into cash within a period of one year. The grey area in the management of current assets or gross working capital is its unpredictability i.e. it is very difficult to ascertain the exact time of conversion of such assets.

B. Permanent / Fixed Working Capital: A part of the investment in current assets is as permanent as the investment in fixed assets. It covers the minimum amount necessary for maintaining the circulation of the current assets. Working capital invested in the circulation of the current assets and keeping it moving is permanently locked up. It is the minimum amount of liquid capital required to keep up the circulation of the capital from cash to inventories to receivables and back again to cash. For example the firm is required to maintain the minimum level of raw material, finished goods or cash balance etc. It may be sub-divided into:

a. *Regular Working Capital:* It is the minimum amount of liquid capital required to keep up the circulation of the capital from cash to inventories to receivables and back again to cash.

b. *Reserve Working Capital:* it means the excess amount over the regular working capital for uncertain circumstances like strike, lock out, depression etc.

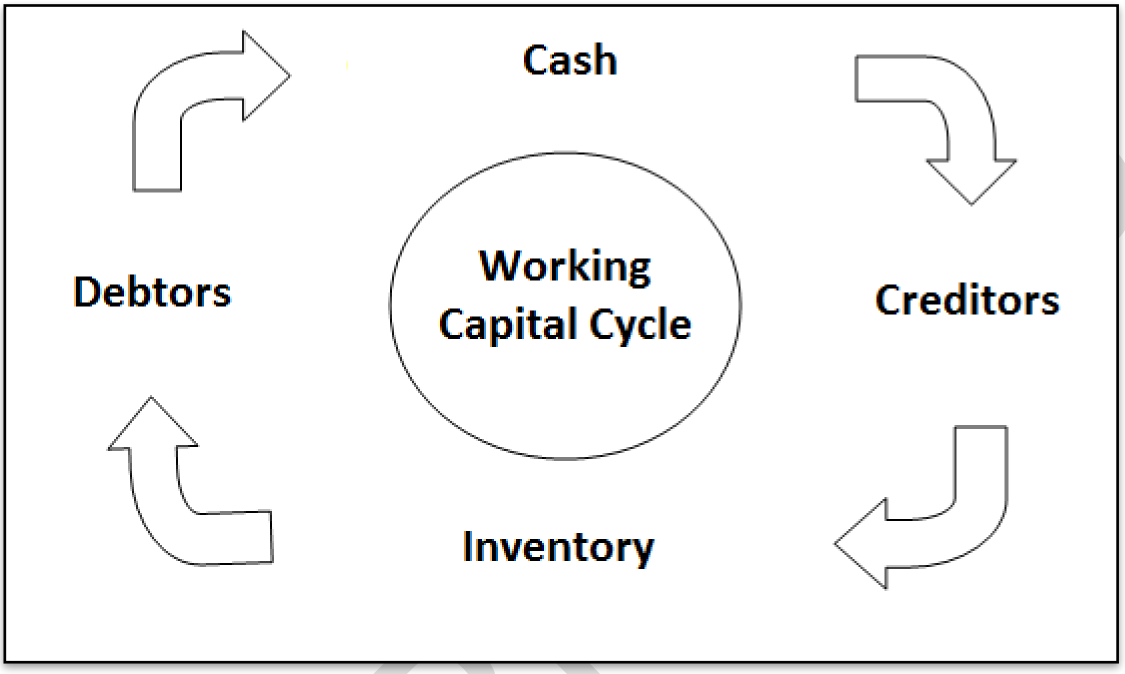
C. Temporary / Variable Working Capital: it is also called variable working capital, which is required to meet the seasonal demands as well as for special purposes.
The variable working capital fluctuates with the volume of business. It may be sub-divided into:

a. *Seasonal* : Seasonal working capital is that temporary increase in working capital which is caused due to some relevant season for the business.

b. *Special working capital*.: it is required for some special purposes of the enterprise. For example advertising the product of the firm requires special working capital.

III. THE WORKING CAPITAL CYCLE

The working capital cycle is the time that elapses between investing in a product or service and receiving payment for that product or service. The starting point of the working capital cycle is usually when the business purchase raw materials or hires people for the service. The ending point of the working capital cycle is when the customer makes the payment, regardless of whether such payment comes pre-paid for the service or purchase, payment takes place at time of purchase or obtaining the service, or the payment comes later owing to sale on credit.



Source: Entrepreneurial-Insights

Cash: The cash refers to the funds available for the purchase of goods. Maintaining a healthy level of liquidity with some buffer is always a best practice.

Creditors and Debtors: A debtor is a person or enterprise that owes money to another party. (The party to whom the money is owed is often a supplier or bank that will be referred to as the creditor.) A creditor is a person, bank, or other enterprise that has lent money or extended credit to another party. (The party to whom the credit has been granted is often a customer that will now be referred to as a debtor.)

Inventory: The raw materials, work-in-process goods and completely finished goods that are considered to be the portion of a business's assets that are ready or will be ready for sale.

IV. AGGRESSIVE APPROACH WORKING CAPITAL

An aggressive working capital policy is one in which you try to squeeze by with a minimal investment in current assets coupled with an extensive use of short-term credit. Your goal is to put as much money to work as possible to decrease the time needed to produce products, turn over inventory or deliver services.

V. CONSERVATIVE APPROACH WORKING CAPITAL

As the name itself suggests, under the approach the finance manager does not undertake risk. As a result, all the working capital needs are primarily financed by long term sources and the use of short term sources may be restricted to unexpected and emergency situation only. The working capital policy of a firm is called a conservative policy when all or most of the working capital needs are met by the long term sources and thus the firm avoids the risk of insolvency.

VI. CONCLUSION

Above we studied about Conservative approach Working Capital, Aggressive approach Working Capital , and working capital management. A company can be endowed with assets and profitability but short of liquidity if its assets cannot readily be converted into cash. Positive working capital is required to ensure that a firm is able to continue its operations and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable and payable, and cash.

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