

A
PROJECT REPORT ON
WORKING CAPITAL MANAGEMENT
AT
KIRLOSKAR PNEUMATICS CO. LTD, HADAPSAR.

Submitted By,
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ACS COLLEGE SONAI
Mula education society sonai



ACKNOWLEDGEMENT

It is a matter of great satisfaction and pleasure to present this report on Working Capital Management of **KIRLOSKAR PNEUMATIC CO. LTD. (KPCL), Pune 411013**. I take this opportunity to owe my thanks to all those involved in my training.

This project report could not have been completed without the guidance of our director, Dr. SHANKAR LAHORE SIR & project guide Prof. Yogesh B Tambe. Their timely help & encouragement helped me to complete this project successfully.

In this context as a student of **"Arts, Commerce and Science College Sonai"** i am grateful to Dr .Shankar Laware (PRINCIPAL)I would like to express my gratitude to Prof. Yogesh B. Tambe for valuable guidance on such worthwhile topic. **"THE STNDY OF WORKING CAPITAL MANAGEMANT.**

Place: Sonai.


Dafal Abhijeet Revnnath

Date

B.B.A (financial management)

DECLARATION

I do hereby declare that the project report entitled
"THE STUDY OF WORKING CAPITAL MANAGEMENT" in
"KIRLOSKAR PNEUMATIC CO. LTD." has been prepared and
submitted as part of the curriculum for the degree of Bachelor of Business
Administration. I also declare that this project is the result of my own efforts and is not the work of any other university
or institution for any other purpose.

Dafal A.R.

Dafal Abhijeet Revnnath

B.B.A 3rd Year


(Financial Management)

CERTIFICATE


This is to certify that **Mr.Dafal Abhijeet Revnnath .student of Mula education society, ACS COLLEGE SONAI.** The department of Bachelor of Business Administration worked on project titled:-**“THE STUDY OF WORKING CAPITAL MANAGEMENT”** has successfully completed his project work in partial fulfillment of Bachelor Of Business Administration. This report is the record of student’s own efforts under our supervision and guidelines.



Project guide.



Internal examiner.



External examiner

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EXECUTIVE SUMMARY

Company being established as Kirloskar pneumatic company limited in 1958, made an entry with manufacture of air compressor and pneumatic tools & soon diversified by including air conditioning & transmission equipments.

At Kirloskar Pneumatic up to date manufacturing facilities, including CNC machines, Stringent quality control procedures and systems, research & development, foundry, heat treatment facilities, screw rotor machines, gear grinding machines, metallurgical laboratories, tool room and integrated computer system, have all been set up with sole idea of achieving the highest standards of quality & performance.

My Project is **the study of working capital management.**

The study was conducted at the head office of Kirloskar Pneumatic Co. Ltd. Pune.

The project was of 2 months duration. During the project I interviewed the executives & staff to collect the data, & also made use of company records & annual reports. The data collected were then compiled, tabulated and analyzed.

Working Capital Management is a very important facet of financial management due to:

- Investments in current assets represent a substantial portion of total investment.
- Investment in current assets & the level of current liabilities have to be geared quickly to change sales.

Some the points to be studied under this topic are:

- ❖ How much cash should a firm hold?
- ❖ What should be the firms credit policy?

How to & when to pay the creditors of the firm

How much to invest in inventories?

OBJECTIVES:

- 1) To identify the financial strengths & weakness of the company.
- 2) Through the net profit ratio & other profitability ratio, understand the profitability of the company.
- 3) Evaluating company's performance relating to financial statement analysis.
- 4) To know the liquidity position of the company with the help of current ratio.
- 5) To find out the utility of financial ratio in credit analysis & determining the financial capacity of the firm.

RESEARCH METHODOLOGY

❖ *Primary Data:*

- The information is collected through the primary sources like:
 - Talking with the employees of the department.
 - Getting information by observations e.g. in manufacturing processes.
 - Discussion with the head of the department.

❖ *Secondary Data:*

- The data is collected through the secondary sources like:
 - Annual Reports of the company.
 - Office manuals of the department.
 - Magazines, Reports in the company.
 - Policy documents of various departments.

OVERVIEW OF KPCL

Established in 1958, Kirloskar pneumatic company limited started with the manufacture of air compressors and pneumatic tools. Immediately thereafter the company expanded its activities in the field of air-conditioning and refrigeration machinery. Further diversification in the manufacture of hydraulic power transmission equipment followed.

Kirloskar pneumatic is held in high esteem for process system engineering and turnkey project expertise. The result of its success in this area is reflected in the company's association with virtually every project and industry in the country.

At Kirloskar pneumatic, up to date manufacturing facilities, including CNC machine stringent quality control procedures and system, R&D, foundry, heat treatment facilities, screw rotor machines, gear grinding machines, metallurgical and metrological labs, tool room, and an integrated computer system have all been set up with the sole idea of achieving the highest standards of quality and performance.

KPCL is among the first few companies in India to secure the ISO 9001 certification in all its operations.

Company's products are manufactured under the survey of renowned inspection agencies such as Lloyd's, MMD, IRS, NTPC, EIL, PDIL, DGS and D, RITES, and many more. And are well accepted not only in India but also in countries of south east Asia, Africa, Gulf, middle east, west Asia, Europe, and U.S.

ACD (Air compressor division) consists of two sub divisions

- ACD machinshop

- ACD assembly

FINANCE DEPARTMENT

Product groups	Major customers	Major competitors	Approx. Market share in %
Screw compressor s diesel driven at 10KG/CM2	well drilling operation.	Atlas Copco, ELGI.	25
Screw compressors electric motor driven at 7 to 10KG/CM2.	Textile, granites industries.	Atlas copco, ELGI	10
Balanced opposed piston compressor driven at 3 to 9 KG/CM2.	Power, Petrochemical, Cement, Steel Industries.	CPT, Ingersol rand.	55
Vertical reciprocating water culled. Driven at 7 to 9 KG/CM2	All small-scale industries.	IR, ELGI	20
Centrifugal compressor Driven by 7 KG/CM2 & above.	Cement, Steel, Textile industries.	Atlas copco, Demag.	Just started.

Rlwys brake Compressor.	All railways.	ELGI	60
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INTRODUCTION:

Management is an art of anticipating and preparing for risks, uncertainties and overcoming obstacles. An essential precondition for sound and consistent assets management is establishing the sound and consistent assets management policies covering fixed as well as current assets. In modern financial management, efficient allocation of funds has a great scope, in finance and profit planning, for the most effective utilization of enterprise resources, the fixed and current assets have to be combined in optimum proportions.

Working capital in simple terms means the amount of funds that a company requires for financing its day-to-day operations. Finance manager should develop sound techniques of managing current assets.

WHAT IS WORKING CAPITAL?

Working capital refers to the investment by the company in short terms assets such as cash, marketable securities. Net current assets or net working capital refers to the current assets less current liabilities.

Symbolically, it means,

Net Current Assets = Current Assets – Current Liabilities.

DEFINITIONS OF WORKING CAPITAL:

The following are the most important definitions of Working capital:

- 1) “Working capital is the difference between the inflow and outflow of funds. In other words it is the net cash inflow.
- 2) Working capital represents the total of all current assets. In other words it is the Gross working capital, it is also known as “Circulating capital” or Current capital for current assets are rotating in their nature.
- 3) Working capital is defined as ‘The excess of current assets over current liabilities and provisions’. In other words it is the ‘Net Current Assets or Net Working Capital.’

IMPORTANCE OF WORKING CAPITAL

Working capital may be regarded as the lifeblood of the business. Without insufficient working capital, any business organization cannot run smoothly or successfully.

In the business the Working capital is comparable to the blood of the human body. Therefore the study of working capital is of major importance to the internal and external analysis because of its close relationship with the current day to day operations of a business. The inadequacy or mismanagement of working capital is the leading cause of business failures.

To meet the current requirements of a business enterprise such as the purchases of services, raw materials etc. working capital is essential. It is also pointed out that working capital is nothing but one segment of the capital structure of a business.

In short, the cash and credit in the business, is comparable to the blood in the human body like finance's life and strength i.e. profit of solvency to the business enterprise. Financial management is called upon to maintain always the right cash balance so that flow of fund is maintained at a desirable speed not allowing slow down. Thus enterprise can have a balance between liquidity and profitability. Therefore the management of working capital is essential in each and every activity.

WORKING CAPITAL MANAGEMENT

INTRODUCTION:

Working Capital is the key difference between the long term financial management and short term financial management in terms of the timing of cash.

Long term finance involves the cash flow over the extended period of time i.e 5 to 15 years, while short term financial decisions involve cash flow within a year or within operating cycle.

Working capital management is a short term financial management.

Working capital management is concerned with the problems that arise in attempting to manage the current assets, the current liabilities & the inter relationship that exists between them. The current assets refer to those assets which can be easily converted into cash in ordinary course of business, without disrupting the operations of the firm.

- Composition of working capital
 - ❖ Major Current Assets
 - 1) Cash
 - 2) AccountsReceivables
 - 3) Inventory
 - 4) MarketableSecurities

 - ❖ Major Current Liabilities
 - 1) Bank Overdraft
 - 2) OutstandingExpenses
 - 3) AccountsPayable
 - 4) BillsPayable

The Goal of Capital Management is to manage the firm's current assets & liabilities, so that the satisfactory level of working capital is maintained. If the firm can not maintain the satisfactory level of working capital, it is likely to become insolvent & may be forced into bankruptcy. To maintain the margin of safety current asset should be large enough to cover its current assets.

Main theme of the theory of working capital management is interaction between the current assets & current liabilities.

CONCEPT OF WORKING CAPITAL:

There are 2 concepts:

- ✓ Gross Working Capital
- ✓ Net Working Capital

Gross working capital: - It is referred as total current assets.

Focuses on,

- Optimum investment in current assets:

Excessive investments impairs firm's profitability, as idle investment earns nothing. Inadequate working capital can threaten solvency of the firm because of its inability to meet its current obligations. Therefore there should be adequate investment in current assets.

- Financing of current assets:

Whenever the need for working capital funds arises, agreement should be made quickly. If surplus funds are available they should be invested in short term securities.

Net working capital (NWC) – defined by 2ways,

- Difference between current assets and current liabilities
- Net working capital is that portion of current assets which is financed with long term funds.

$\text{NET WORKING CAPITAL} = \text{CURRENT ASSETS} - \text{CURRENT LIABILITIES}$

If the working capital is efficiently managed then liquidity and profitability both will improve. They are not components of working capital but outcome of working capital. Working capital is basically related with the question of profitability versus liquidity & related aspects of risk.

Implications of Net Working Capital:

Net working capital is necessary because the cash outflows and inflows do not coincide. In general the cash outflows resulting from payments of current liability are relatively predictable. The cash inflows are however difficult to predict. More predictable the cash inflows are, the less NWC will be required. But where the cash inflows are uncertain, it will be necessary to maintain current assets at level adequate to cover current liabilities that are there must be NWC.

For evaluating NWC position, an important consideration is trade off between probability and risk.

The term profitability is measured by profits after expenses. The term risk is defined as the probability that a firm will become technically insolvent so that it will not be able to meet its obligations when they become due for payment. The risk of becoming technically insolvent is measured by NWC.

If the firm wants to increase profitability, the risk will definitely increase. If firm wants to reduce the risk, the profitability will decrease.

PLANNING OF WORKING CAPITAL:

Working capital is required to run day to day business operations. Firms differ in their requirement of working capital (WC). Firm's aim is to maximize the wealth of share holders and to earn sufficient return from its operations.

WCM is a significant facet of financial management. Its importance stems from two reasons:

- Investment in current asset represents a substantial portion of total investment.
- Investment in current assets and level of current liability has to be geared quickly to change in sales.

Business undertaking required funds for two purposes:

- To create productive capacity through purchase of fixed assets.
- To finance current assets required for running of the business.

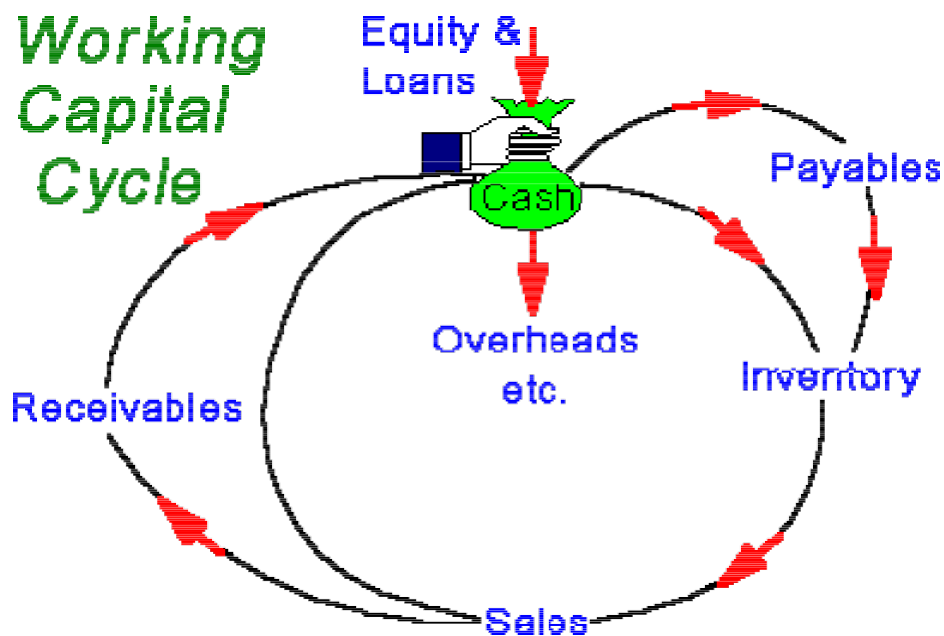
The importance of WCM is reflected in the fact that financial managers spend a great deal of time in managing current assets and current liabilities.

The extent to which profit can be earned is dependent upon the magnitude of sales. Sales are necessary for earning profits. However, sales do not

convert into cash instantly; there is invariably a time lag between sale of goods and the receipt of cash. WC management affect the profitability and liquidity of the firm which are inversely proportional to each other, hence proper balance should be maintained between two.

To convert the sale of goods into cash, there is need for WC in the form of current asset to deal with the problem arising out of immediaterealization of cash against good sold. Sufficient WC is necessary to sustain sales activity. This is referred to as the operating or cash cycle.

WORKING CAPITAL CYCLE:



A firm requires many years to recover initial investment in fixed assets. On contrary the investment in current asset is turned over many times a year. Investment in such current assets is realized during the operating cycle of the firm.

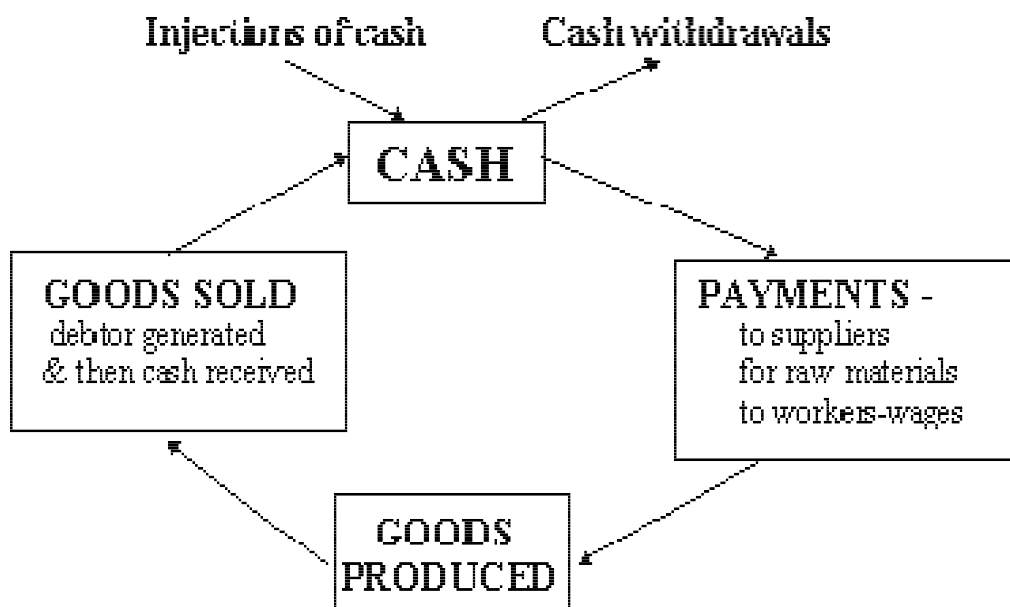
Each component of working capital (namely inventory, receivables and payables) has two dimensions... TIME.....and MONEY. When it comes to managing working capital - TIME IS MONEY. If you can get money to move faster around the cycle (e.g. collect dues from debtors more quickly) or reduce the amount of money tied up (e.g. reduce inventory levels relative to sales), the business will generate more cash or it will need to borrow less money to fund working capital. As a consequence, you could reduce the cost of bank interest or you'll have additional free money available to support additional sales growth or investment. Similarly, if you can negotiate improved terms with suppliers e.g. get longer credit or an increased credit limit; you effectively create free finance to help fund future sales.

It can be tempting to pay cash, if available, for fixed assets e.g. computers, plant, vehicles etc. If you do pay cash, remember that this is now longer available for working capital. Therefore, if cash is tight, consider other ways of financing capital investment - loans, equity, leasing etc. Similarly, if you pay dividends or increase drawings, these are cash outflows and, like water flowing down a plughole, they remove liquidity from the business

If you ...	Then ...
<ul style="list-style-type: none"> Collect receivables (debtors) faster. 	<ul style="list-style-type: none"> You release cash from the cycle.
<ul style="list-style-type: none"> Collect receivables (debtors) slower. 	<ul style="list-style-type: none"> Your receivables soak up cash.
<ul style="list-style-type: none"> Get better credit (in terms of duration or amount) from suppliers. 	<ul style="list-style-type: none"> You increase your cash resources.
<ul style="list-style-type: none"> Shift inventory (stocks) faster. 	<ul style="list-style-type: none"> You free up cash.
<ul style="list-style-type: none"> Move inventory (stocks) slower. 	<ul style="list-style-type: none"> You consume more cash.

Operating cycle:

The working capital cycle refers to the length of time between the firms paying the cash for materials, etc., entering into production process/stock & the inflow of cash from debtors (sales), suppose a company has certain amount of cash it will need raw materials. Some raw materials will be available on credit but, cash will be paid out for the other part immediately. Then it has to pay labour costs & incurs factory overheads. These three combined together will constitute work in progress. After the production cycle is complete, work in progress will get converted into sundry debtors. Sundry debtors will be realized in cash after the expiry of the credit period. This cash can be again used for financing raw material, work in progress etc. thus there is complete cycle from cash to cash wherein cash gets converted into raw material, work in progress, finished goods and finally into cash again. Short term funds are required to meet the requirements of funds during this time period. This time period is dependent upon the length of time within which the original cash gets converted into cash again. The cycle is also known as operating cycle or cash cycle.



Working capital cycle can be determined by adding the number of days required for each stage in the cycle. For example, company holds raw material on average for 60 days, it gets credit from the supplier for 15 days, finished goods are held for 30 days & 30 days credit is extended to debtors. The total days are 120, i.e., $60 - 15 + 15 + 15 + 30 + 30$ days is the total of working capital.

Thus the working capital cycle helps in the forecast, control & management of working capital. It indicates the total time lag & the relative significance of its constituent parts. The duration may vary depending upon the business policies. In light of the facts discussed above we can broadly classify the operating cycle of a firm into three phases viz.

- 1 Acquisition of resources.
- 2 Manufacture of the product and
- 3 Sales of the product (cash / credit).

First and second phase of the operating cycle result in cash outflows, and be predicted with reliability once the production targets and cost of inputs are known.

However, the third phase results in cash inflows which are not certain because sales and collection which give rise to cash inflows are difficult to forecast accurately.

Operating cycle consists of the following:

- ❖ Conversion of cash into raw-materials;
- ❖ Conversion of raw-material into work-in-progress;
- ❖ Conversion of work-in-progress into finished stock;
- ❖ Conversion of finished stock into accounts receivable through sales;
and
- ❖ Conversion of accounts receivable into cash.

In the form of an equation, the operating cycle process can be expressed as follows:

Operating cycle = R + W + F + D - C

R = Raw material storage period

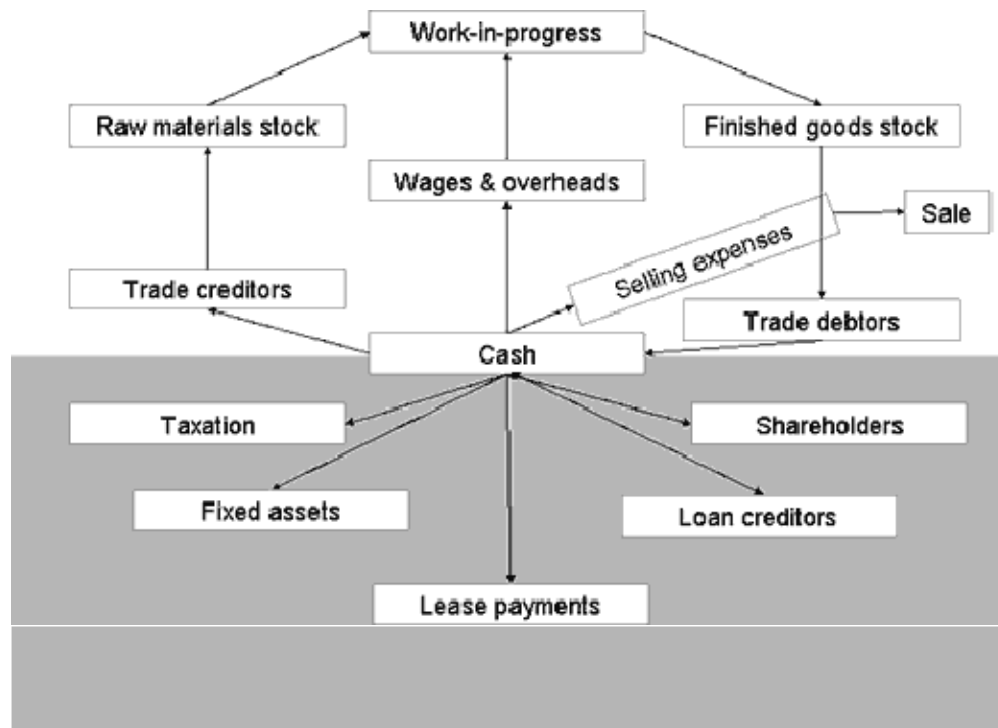
W = Work in progress holding period

F = Finished goods storage period

D = Debtors collection period

C = Credit period availed

Operating cycle for manufacturing firm:



The firm is therefore, required to invest in current assets for smooth and uninterrupted functioning.

RMCP	- Raw Material ConversionPeriod
WIPCP	- Work in Progress ConversionPeriod
FGCP	- Finished Goods ConversionPeriod
ICP	- Inventory ConversionPeriod
RCP	- Receivables ConversionPeriod
Payables(PDP)	- Payables Deferral Period
NOC	- Net Operating Cycle
GOC	- Gross OperatingCycle

Here, the length of GOC is the sum of ICP and RCP.

ICP is the total time needed for producing and selling the products. Hence it is the sum total of RMCP, WIPCP and FGCP. On the other hand, RCP is the total time required to collect the outstanding amount from customers.

Usually, firm acquires resources on credit basis. PDP is the result of such an incidence and it represent the length of time the firm is able to defer payments on various resources purchased.

The difference between GOC and PDP is know as Net Operating Cycle and if Depreciation is excluded from the expenses in computation of operating cycle, the NOC also represents the cash collection from sale and cash payments for resources acquired by the firm and during such time interval between cash collection from sale and cash payments for resources acquired by the firm and during such time interval over which additional funds called working capital should be obtained in order to carry out the firms operations. In short, the working capital position is directly proportional to the Net Operating Cycle.

Calculations:

On the basis of financial statement of an organization we can calculate the inventory conversion period. Debtors / receivables conversion period and the creditors conversion period and based on such calculations we can find out the length of the operating cycle (in days) both gross as well as net operating cycle.

As mentioned above, on the basis of information presented in the Balance sheet and CMA statement of Kirloskar Pneumatics Company Limited, the length of gross as well as net operating cycle is calculated as follows:

Particulars	2017-18	2018-19	2019-20	2020-21
Material Cost	9132.58	11099.03	12084.02	15771.59
Labour Cost	3597.64	3115.99	3336.02	3681.33
Direct Expenses	-	-	-	-
Prime Cost	12730.22	14215.02	15420.04	19452.52
+ Manufacturing Exp.	2103.89	1977.51	2080.21	2733.89
Cost of Production	14834.11	16192.53	17500.25	22186.81
+Opening WIP	284.22	1003.23	1025.54	1261.56
- Closing WIP	1003.23	1025.54	1261.56	1327.47
Cost of Goods Produced	14115.1	16170.22	17264.23	22120.9
+Opening FG	286.13	330.66	115.71	260.64
-Closing FG	330.66	115.71	260.64	315.02
Cost of Goods Sold	14070.57	16385.17	17119.3	22066.52

❖ **Operating Cycle for the year 2020-21**

a. RMCP = $\frac{\text{Average Stock}}{\text{Annual Consumption}} \times 360 = 54 \text{ days}$

b. WIPCP = $\frac{\text{Average Stock}}{\text{Cost of Production}} \times 360 = 21 \text{ days}$

c. FGCP = $\frac{\text{Average Stock}}{\text{Cost of Goods Sold}} \times 360 = 5 \text{ days}$

d. Debtors Conversion Period = $\frac{\text{Average Debtors}}{\text{Cost of sales}} \times 360 = 123 \text{ days}$

e. Payables Deferral Period = $\frac{\text{Average Creditors}}{\text{Cost of Goods Sold}} \times 360 = 87 \text{ days}$

Gross operating Cycle = 54 + 21 + 5 + 123 = 203 days

Net Operating Cycle = 203 – 87 = 116 days

Operating Cycle for the year 2019-20

1 RMCP = 59 days

2 WIPCP = 24 days

3 FGCP = 4 days

4 Debtors Conversion Period = 149 days

5 Payable Deferral Period = 132 days.

Gross operating Cycle = $59 + 24 + 4 + 149 = 236$ days

Net Operating Cycle = $236 - 132 = 104$ days

Operating Cycle for the year 2018-19

- 1 RMCP = 48 days
- 2 WIPCP = 23days
- 3 FGCP = 5days
- 4 Debtors Conversion Period = 181days
- 5 Payable Deferral Period = 162 days.

Gross operating Cycle = $48 + 23 + 5 + 181 = 257$ days

Net Operating Cycle = $257 - 162 = 95$ days

Operating Cycle for the year 2017-18

- a. RMCP = 64 days
- b. WIPCP = 27days
- c. FGCP = 9days
- d. Debtors Conversion Period = 112days
- e. Payable Deferral Period = 137 days.

Gross operating Cycle = $64 + 27 + 9 + 112 = 212$ days

Net Operating Cycle = $212 - 137 = 75$ days

Types of working capital:

- 1) PERMANENTAND
- 2) VARIABLE WORKINGCAPITAL

The need for current assets arises because of the operating cycle. The operating cycle is a continuous process and, therefore, the need for current assets is felt constantly. But the magnitude of current assets needed is not always a minimum level of current assets which is continuously required by the firm to carry on its business operations. This minimum level of current assets is referred to as permanent, or fixed, working capital. It is permanent in the same way as the firm's fixed assets are. Depending upon the changes in production and sales, the need for working capital, over and above permanent working capital, will fluctuate. For example, extra inventory of finished goods will have to be maintained to support the peak periods of sales, and investment in receivable may also increase during such periods. On the other hand, investment in raw material, work-in-process and finished goods will fall if the market is slack.

The extra working capital, needed to support the changing production and sales activities is called FLUCTUATING, or VARIABLE, or TEMPORARY working capital. Both kinds of working capital PERMANENT and TEMPORARY - are necessary to facilitate production and sale through the operating cycle, but temporary-working capital is created by the firm to meet liquidity requirements that will last only temporary working capital. It is shown that permanent working capital is stable over time.

While temporary working capital is fluctuating- sometimes increasing and sometimes decreasing. However, the permanent capital is difference between permanent and temporary working capital can be depicted through figure.

BALANCED WORKING CAPITAL POSITION

The firm should maintain a sound working capital position. It should have adequate working capital to run its business operations. Both excessive as

well as inadequate working capital positions are dangerous from the firm's point of view. Excessive working capital not only impairs the firm's profitability but also result in production interruptions and inefficiencies.

The dangers of excessive working capital are as follows:

- It results in unnecessary accumulation of inventories. Thus, chances of inventory mishandling, waste, theft and losses increase.
- It is an indication of defective credit policy slack collections period. Consequently, higher incidence of bad debts results, which adversely affects profits.
- Excessive working capital makes management complacent which degenerates into managerial inefficiency.
- Tendencies of accumulating inventories tend to make speculative profits grow. This may tend to make dividend policy liberal and difficult to cope with in future when the firm is unable to make speculative profits.

Inadequate working capital is also bad and has the following dangers:

- It stagnates growth. It becomes difficult for the firm to undertake profitable projects for non-availability of working capital funds.
- It becomes difficult to implement operating plans and achieve the firm's profit target.
- Operating inefficiencies creep in when it becomes difficult even to meet day commitments.
- Fixed assets are not efficiently utilized for the lack of working capital funds. Thus, the firm's profitability would deteriorate.
- Paucity of working capital funds render the firm unable to avail attractive credit opportunities etc.

- The firm loses its reputation when it is not in a position to honour its short-term obligations.

As a result, the firm faces tight credit terms.

An enlightened management should, therefore, maintain the right amount of working capital on a continuous basis. Only then a proper functioning of business operations will be ensured. Sound financial and statistical techniques, supported by judgment, should be used to predict the quantum of working capital needed at different time periods.

A firm's net working capital position is not only important as an index of liquidity but it is also used as a measure of the firm's risk.

Risk in this regard means chances of the firm being unable to meet its obligations on due date. The lender considers a positive net working as a measure of safety. All other things being equal, the more the net working capital a firm has, the less likely that it will default in meeting its current financial obligations. Lenders such as commercial banks insist that the firm should maintain a minimum net working capital position.

DETERMINANTS OF WORKING CAPITAL

There are no set rules or formula to determine the working capital requirements of firms. A large number of factors, each having a different importance, influence working capital needs of firms. Also, the importance of factors changes for a firm over time. Therefore, an analysis of relevant factors should be made in order to determine total investment in working capital. The following is the description of factors which generally influence the working capital requirements of firms.

- ✓ Nature of Business
- ✓ Sales and Demand Conditions
- ✓ Technology and Manufacturing Policy
- ✓ Credit Policy

- ✓ Availability of Credit
- ✓ Operating Efficiency
- ✓ Price Level Changes

Nature of Business:

Working capital requirements of a firm are basically influenced by the nature of its business. Trading and financial firms have a very small investment in fixed assets, but require a large sum of money to be invested in working capital. Retail stores, for example, must carry large stocks of a variety of goods to satisfy varied and continuous demand of their customers. Some manufacturing business, such as tobacco manufacturers and construction firm, also have to invest substantially in working capital and a nominal amount in fixed assets. In contrast, public utilities have a very limited need for working capital and have to invest abundantly in fixed assets. Their working capital requirements are nominal because they may have only cash and supply services, not products. Thus, no funds will be tied up in debtors and stock (inventories). Working capital requires most of the manufacturing concerns to fall between the two extreme requirements of trading firms and public utilities. Such concerns have to make adequate investment in current assets depending upon the total assets structure and other variables.

Sales and Demand Conditions:

The working capital needs of a firm are related to its sales. It is difficult to precisely determine the relationship between volume of sales and working capital needs. In practice, current assets will have to be employed before growth takes place. It is, therefore, necessary to make advance planning of working capital for a growing firm on a continuous basis.

A growing firm may need to invest funds in fixed assets in order to sustain its growing production and sales. This will, in turn, increase investment in current assets to support enlarged scale of operations. It should be realized

that a growing firm needs funds continuously. It uses external sources as well as internal sources to meet increasing needs of funds. Such a firm faces further financial problems when it retains substantial portion of its profits. It would not be able to pay dividends to shareholders. It is, therefore, imperative that proper planning be done by such companies to finance their increasing needs for working capital.

Sales depend on demand conditions. Most firms experience seasonal and cyclical fluctuations in the demand for their products and services. These business variations affect the working capital requirements, specially the temporary working capital requirement of the firm. When there is an upward swing in the economy, sales will increase; correspondingly, the firm's investment in inventories and debtors will also increase. Under boom, additional investment in fixed assets may be made by some firms to increase their productive capacity. This act of firm will require further additions of working capital. To meet their requirements of funds for fixed assets and current assets under boom further additions of working capital. To meet their requirements of funds for fixed assets and current assets under boom period, firms generally resort to substantial borrowing. On the other hand, when there is a decline in the economy, sales will fall and consequently, levels of inventories and debtors will also fall. Under recessionary conditions, firms try to reduce their short term borrowings.

Seasonal fluctuations not only affect working capital requirements but also create production problems for the firm. During periods of peak demand, increasing production may be expensive for the firm. Similarly, it will be more expensive during slack periods when the firm has to sustain its working force and physical facilities without adequate production and sales. A firm may, thus, follow a policy of steady production, irrespective of seasonal changes in order to utilize its resources to the fullest extent. Such

a policy will mean accumulation of inventories during off season and their quick disposal during the peak season.

The increasing level of inventories during the slack season will require increasing funds to be tied up in the working capital for some months. Unlike cyclical fluctuations, seasonal fluctuations generally conform to a steady pattern. Therefore, financial arrangements for seasonal working capital requirements can be made in advance. However, the financial plan or arrangement should be flexible enough to take care of some abrupt seasonal fluctuations.

Technology and Manufacturing Policy

The manufacturing cycle (or the inventory conversion cycle) comprises of the purchase and use of raw material the production of finished goods. Longer the manufacturing cycle, larger will be the firm working capital requirements. For example, the manufacturing cycle in the case of a boiler, depending on its size, may range between six to twenty- four months. On the other hand, the manufacturing cycle of products such as detergent powder, soaps, chocolate etc. may be a few hours. An extended manufacturing time span means a larger tie- up of funds in inventories. Thus, if there are alternative technologies of manufacturing a product, the technological process with the shortest manufacturing cycle may be chosen. Once a manufacturing technology has been selected, it should be ensured that manufacturing cycle is completed within the specified period. This needs proper planning and coordination at all levels of activity. Any delay in manufacturing process will results in accumulation of work- in- process and waste of time. In order to minimize their investment in working capital, some firms, especially firm

Manufacturing industrial products have a policy of asking for advance payment from their customers. Non-manufacturing firms, service and financial enterprises do not have a manufacturing cycle.

A strategy of constant production may be maintained in order to resolve the working capital problems arising due to seasonal changes in the demand for the firm product. A steady production policy will cause inventories to accumulate during the off- reason periods and the firm will be exposed to greater inventory costs and risks. Thus, if costs and risks of maintaining a constant production policy, varying its production utilized for manufacturing varied products, can have the advantage of diversified Activities and solve their working capital problems. They will manufacture the original product line during its increasing demand and when it has an off - season, other products may be manufactured to utilize physical resources and working force. Thus, production policies will differ from firm to firm, depending on the circumstances of individual firm.

Credit Policy

The credit policy of the firm affects the working capital by influencing the level of debtors. The credit terms to be granted to customers may depend upon the norms of the industry to which the firm belongs. But a firm has the flexibility of shaping its credit policy within the constraint of industry norms and practices. The firm should be discretion in granting credit terms to its customers. Depending upon the individual case, different terms may be given to different customers. A liberal credit policy, without rating the credit-worthiness of customers, will be detrimental to the firm and will create a problem of collections. A high collection period will mean tie- up of large funds in book debts. Slack collection procedures can increase the chance of bad debts.

In order to ensure that unnecessary funds are not tied up in debtors, the firm should follow a rationalized credit policy based on the credit standing of

customers and periodically review the creditworthiness of the exiting customers. The case of delayed payments should be thoroughly investigated.

Availability of Credit

The working capital requirements of a firm are also affected by credit terms granted by its creditors. A firm will need less working capital if liberal credit terms are available to it. Similarly, the availability of credit from banks also influences the working capital needs of the firm. A firm which can get bank credit easily on favorable condition will operate with less working capital than a firm without such a facility.

Operating Efficiency

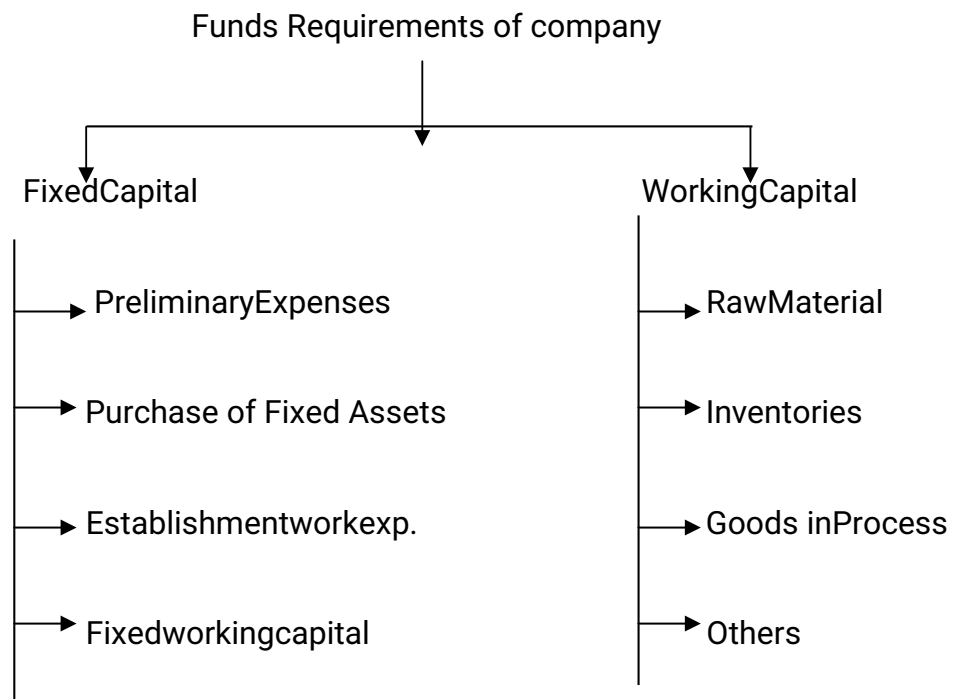
The operating efficiency of the firm relates to the optimum utilization of resources at minimum costs. The firm will be effectively contributing in keeping the working capital investment at a lower level if it is efficient in controlling operating costs and utilizing current assets. The use of working capital is improved and pace of cash conversion cycle is accelerated with operating efficiency. Better utilization of resources improves profitability and, thus, helps in releasing the pressure on working capital. Although it may not be possible for a firm to control prices of materials or wages of labour, it can certainly ensure efficiency and effective use of its materials, labour and other resources.

Price Level Changes

The increasing shifts in price level make functions of financial manager difficult.

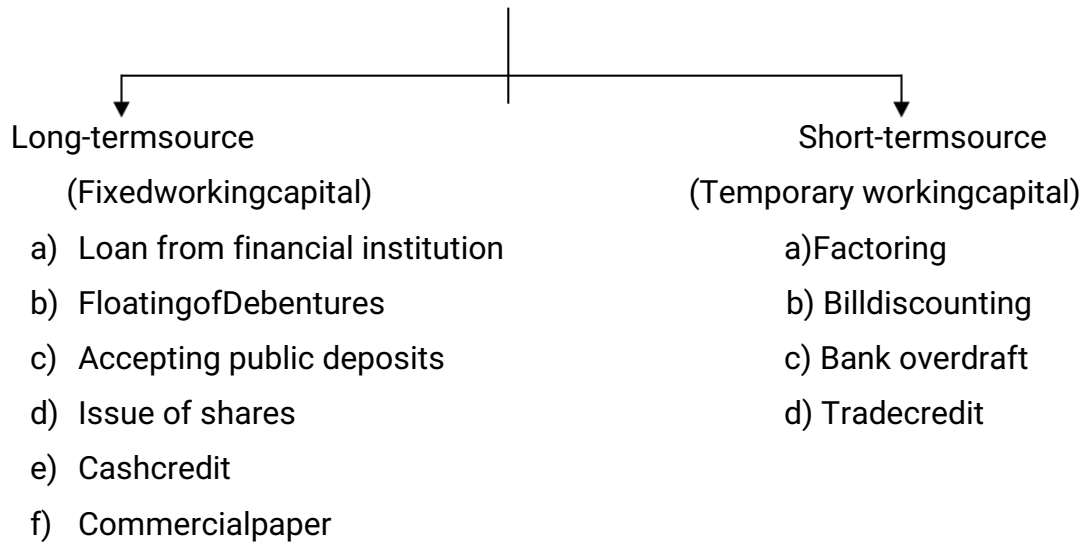
He should anticipate the effect of price level changes on working capital requirement of the firm. Generally, rising price levels will require a firm to maintain higher amount of working capital. Same levels of current assets will need increased investment when price are increasing. However, companies which can immediately revise their product price levels will not face a server working capital problem. Further, effects of increasing general price level will be felt differently by firm as individual price may move differently. It is possible that some companies may not be affected by rising price will be different for companies. Some will face no working capital problem, while working capital problems of other may be aggravated.

REQUIREMENTS OF FUNDS



Every company requires funds for investing in two types of capital i.e. fixed capital, which requires long-term funds, and working capital, which requires short-term funds.

SOURCES OF WORKING CAPITAL



Sources of additional working capital include the following:

- Existing cash reserves
- Profits (when you secure it as cash!)
- Payables (credit from suppliers)
- New equity or loans from shareholders
- Bank overdrafts or lines of credit
- Term loans

If you have insufficient working capital and try to increase sales, you can easily over-stretch the financial resources of the business. This is called overtrading. Early warning signs include:

- Pressure on existing cash

- Exceptional cash generating activities e.g. offering high discounts for early cash payment
- Bank overdraft exceeds authorized limit
- Seeking greater overdrafts or lines of credit
- Part-paying suppliers or other creditors
- Paying bills in cash to secure additional supplies
- Management pre-occupation with surviving rather than managing
- Frequent short-term emergency requests to the bank (to help pay wages, pending receipt of a cheque).

LONG TERM SOURCES

ISSUE OF SHARES

Ordinary shares are also known as equity shares and they are the most common form of share in the UK. An ordinary share gives the right to its owner to share in the profits of the company (dividends) and to vote at general meetings of the company.

Since the profits of companies can vary wildly from year to year, so can the dividends paid to ordinary shareholders. In bad years, dividends may be nothing whereas in good years they may be substantial.

The nominal value of a share is the issue value of the share - it is the value written on the share certificate that all shareholders will be given by the company in which they own shares.

The market value of a share is the amount at which a share is being sold on the stock exchange and may be radically different from the nominal value.

When they are issued, shares are usually sold for cash, at par and/or at a premium. Shares sold at par are sold for their nominal value only - so if Rs.10 share is sold at par, the company selling the share will receive Rs. 10 for every share it issues.

If a share is sold at a premium, as many shares are these days, then the issue price will be the par value plus an additional premium.

DEBENTURES

Debentures are loans that are usually secured and are said to have either fixed or floating charges with them.

A secured debenture is one that is specifically tied to the financing of a particular asset such as a building or a machine. Then, just like a mortgage for a private house, the debenture holder has a legal interest in that asset and the company cannot dispose of it unless the debenture holder agrees. If the debenture is for land and/or buildings it can be called a mortgage debenture.

Debenture holders have the right to receive their interest payments before any dividend is payable to shareholders and, most importantly, even if a company makes a loss, it still has to pay its interest charges.

If the business fails, the debenture holders will be preferential creditors and will be entitled to the repayment of some or all of their money before the shareholders receive anything.

LOANS FROM OTHER FINANCIAL INSTITUTIONS

The term debenture is a strictly legal term but there are other forms of loan or loan stock. A loan is for a fixed amount with a fixed repayment schedule and may appear on a balance sheet with a specific name telling the reader exactly what the loan is and its main details.

SHORT TERM SOURCES

FACTORING

Factoring allows you to raise finance based on the value of your outstanding invoices. Factoring also gives you the opportunity to outsource

your sales ledger operations and to use more sophisticated credit rating systems. Once you have set up a factoring arrangement with a Factor, it works this way:

Once you make a sale, you invoice your customer and send a copy of the invoice to the factor and most factoring arrangements require you to factor all your sales. The factor pays you a set proportion of the invoice value within a pre-arranged time - typically, most factors offer you 80-85% of an invoice's value within 24 hours.

The major advantage of factoring is that you receive the majority of the cash from debtors within 24 hours rather than a week, three weeks or even longer.

INVOICE DISCOUNTING

Invoice discounting enables you to retain the control and confidentiality of your own sales ledger operations.

The client company collects its own debts. '**Confidential invoice discounting**' ensures that customers do not know you are using invoice discounting as the client company sends out invoices and statements as usual. The invoice discounter makes a proportion of the invoice available to you once it receives a copy of an invoice sent.

Once the client receives payment, it must deposit the funds in a bank account controlled by the invoice discounter. The invoice discounter will then pay the remainder of the invoice, less any charges.

The requirements are more stringent than for factoring. Different invoice discounters will impose different requirements.

OVERDRAFT FACILITIES

Many companies have the need for external finance but not necessarily on a long-term basis. A company might have small cash flow problems from

time to time but such problems don't call for the need for a formal long-term loan. Under these circumstances, a company will often go to its bank and arrange an overdraft. Bank overdrafts are given on current accounts and the good point is that the interest payable on them is calculated on a daily basis. So if the company borrows only a small amount, it only pays a little bit of interest. Contrast the effects of an overdraft with the effects of a loan.

TRADE CREDIT

This source of finance really belongs under the heading of working capital management since it refers to short-term credit. By a 'line of credit' they mean that a creditor, such as a supplier of raw materials, will allow us to buy goods now and pay for them later. Why do they include lines of credit as a source of finance? They'll, if they manage their creditors carefully they can use the line of credit they provide for us to finance other parts of their business.

Take a look at any company's balance sheet and see how much they have under the heading of 'Creditors falling due within one year' - let's imagine it is Rs. 25,000 for a company. If that company is allowed an average of 30 days to pay its creditors then they can see that effectively it has a short term loan of Rs. 25,000 for 30 days and it can do whatever it likes with that money as long as it pays the creditor on time.

CASH MANAGEMENT

Cash management is one of the key areas of WCM. Apart from the fact that it is the most liquid asset, cash is the common denominator to which all current assets, that is, receivables & inventory get eventually converted into cash.

Cash is oil of lubricate the ever-turning wheels of business: without it the process grinds to a stop.

Motives for holding cash

Cash with reference to cash management is used in two senses:

- It is used broadly to cover currency and generally accepted equivalents of cash, such as cheques, drafts and demand deposits in banks.
- It includes near-cash assets, such as marketable securities & time deposits in banks.

CASH IS MAINTAINED FOR FOUR MOTIVES:

A. Transaction motive:

Transaction motive refer to the holding of cash to meet routine cash requirements to finance the transactions which a firm carries on in a variety of transactions to accomplish its objectives which have to be paid for in the form of cash. E.g. payment for purchases, wages, operating expenses, financial charges like interest, taxes, dividends etc. Thus requirement of cash balances to meet routine need is known as the transaction motive and such motive refers to the holding of cash to meet anticipated obligations whose timing is not perfectly synchronized with cash receipts.

B. Precautionary motive:

A firm has to pay cash for the purposes which can not be predicted or anticipated. The unexpected cash needs at the short notice may be due to:

- Floods, strikes & failure of customer
- Slow down in collection of current receivables
- Increase in cost of raw material
- Collection of some order of goods as customer is not satisfied

The cash balance held in reserves for such random and unforeseen fluctuations in cash flows are called as precautionary balance. Thus, precautionary cash provides a cushion to meet unexpected contingencies. The more unpredictable are the cash flows, the larger is the need for such balance.

C. Speculativemotive:

It refers to the desire of the firm to take advantage of opportunities which present themselves at unexpected moment & which are typically outside the normal course of business. If the precautionary motive is defensive in nature, in that firms must make provisions to tide over unexpected contingencies, the speculative motive represents a positive and aggressive approach. The speculative motive helps to take advantages of:

- An opportunity to purchase raw material at reduced price on payment of immediate cash.
- A chance to speculate on interest rate movements by buying securities when interest rates are expected to decline.
- Make purchases at favorable price.
- Delay purchase of raw material on the anticipation of decline in prices.

OBJECTIVES OF CASH MANAGEMENT:

- I. To meet the cash disbursement needs –
 - In the normal course of business firms have to make payment of cash on a continuous and regular basis to the supplier of goods, employees and so on. Also the collection is done from the debtor. Basic objective is to meet payment schedule that is to have sufficient cash to meet the cash disbursement needs of the firm.

- II. To minimize the funds committed to cash balances–

First of all if we keep high cash balance, it will ensure prompt payment together with all the advantages. But it also implied that the large funds will remain idle, as cash is the non-earning asset and firm will have to forego profits. On the other hand, low cash balance mean failure to meet payment schedule. Therefore we should have optimum level of cash balance.

FACTORS DETERMINING CASH NEEDS:

- 1) Synchronization of cash - need for the cash balances arises from the non-synchronization of the inflows & outflows of cash. First need in determining cash needs is, the extent of non-synchronization of cash receipts & disbursements. For this purpose cash budget is to be prepared. Cash budget point out when the firm will have excess or shortage of cash.
- 2) Short cash – Cash period reveals the period of cash shortages. Every shortage of cash whether expected or unexpected involves a cost depending upon the security, duration & frequency of shortfall & how the shortage is covered. Expenses incurred as a shortfall are called short costs.

There are following costs included in the short cash–

- Transaction cost: this is usually the brokerage incurred in relation to the some short-term near-cash assets like marketable securities.
- Borrowing costs: these include interest on loan, commitment charges & other expenses relating to loan.
- Loss of cash discount: that s a loss because of temporary shortage of cash.
- Cost associated with deterioration of credit rating.
- Penalty rates: By a bank to meet a shortfall in compensating balances.

1) Excess cash balance - cost associated with excessively large cash balances is known as excess cash balance cost. If large funds are idle the implication is that the firm has missed the opportunity to invest those funds and has thereby lost interest. This loss of interest is primarily the excess cost.

2) Procurement & Management cost – cost associated with establishing and operating cash management staff and activities. They are generally fixed and accounted for by salary, handling of securities etc.

3) Uncertainty – the first requirement in cash management is Precautionary cushion to cope with irregularities in cash flows, unexpected delays in collection & disbursements, defaults and unexpected cash needs.

Impact can be reduced through:

- Improved forecasting of tax payments, capital expenditure, dividends etc.
- Increased ability to borrow through overdraft facility.

DETERMINING THE CASH NEEDS:

Cash needs can be determined though preparing cash budget, for year, month, week etc.

Cash reports, providing a comparison of actual development with forecast figures, are helpful in controlling and revising cash forecasts on a continual basis. The important cash reports are

- The daily cash reports
- Daily treasury reports
- The monthly cash report

Monitoring collection and receivables:

The Finance Manager must control the levels of cash balance at various points in the organization. This task assumes special importance on account of the fact that there is generally a tendency amongst divisional managers to keep cash balance in excess of their needs. Hence a finance manager must devise a system whereby each division of organization retains enough cash to meet its day-to-day requirements without having surplus balance on hand. For this, methods have to be employed to:

Speed up the mailing time of payment from customers

Reduce the time during which payments received by the firm remain uncollected and speed up the movement of funds to disbursement banks.


For this purpose, the following can be helpful:


- 1 Prompt billing – often there is a time lag between the dispatch of goods or provision of service and the sending of bills. By preparing and sending the bills promptly, a firm can ensure earlier remittance. It should be realized that it is in the area of billing that the company's control is high and there is a sizeable opportunity to free up cash.


For this, the treasurer should work with the controller and others in:


- ✚ Accelerating invoice data
- ✚ Mailing bills promptly
- ✚ Identifying payment locations.


- 2 Expeditious collection of cheques - expediting collection of cheques is important and there are two methods: 1. Concentration banking, 2. Lock box method

-  Concentration banking : (decentralized collection) key elements are, The major bank account of the company is set up with a concentration bank, generally situated in the same place where the company is head quartered. Customers are advised to mail their remittances to collection centre close to them. Payments collected in different collection centres are deposited in local banks which in turn transfer them to the concentration banks


-  Lock box method: Similar features are as follows –
 - ⇒ A number of post office boxes are rented by the company in different locations.
 - ⇒ Customers are advised to mail their remittances to the lock boxes.
 - ⇒ Banks are authorized to pick up the cheques from the lock boxes and deposit them in the company's account.

-  Controlling payables/disbursements: by proper control of payables company can manage cash resources. This involves –
 - Payment should be made as and when it falls due.
 - Centralized disbursement – payables and their disbursements may be centralized. This helps in consolidating the funds at head office scheduling payments, reducing unproductive bank balance and investing surplus funds more effectively.

-  Proper synchronization of inflows and outflows helps a company to get greater mileage from cash resources.

-  Float: when firm issues cheques they reduce the balance in their books, but balance in bank's book is not reduced till the payment is made by bank. This amount of cheques issued by the firm but not paid for by the bank is referred to as payment

float'. When the cheques are deposited with bank the firm increases the balance in its books. The balance in the bank's book however is cleared. The amount of cheques deposited by the firm in the bank but not cleared is referred to as 'collection float'. Difference between payment float and collection float is called as "net float". When the net float is positive the balance in the books of bank is higher than the balance in the books of firm. When the firm enjoys the positive float (net) it may issue cheques even if it have an overdrawn bank account in its books. Such an action is referred to as 'playing the float' it is considered risky.

 **Accruals:** accruals can be defined as current liabilities that represent a service or goods received by a firm but not yet paid for. For example remuneration to employee's that render services in advance and receive payment later. In a way, they extend credit to the firm for a period at the end of which they are paid. Weekly is more important as compared to monthly. Other examples, rent to lessors, taxes to government.

OPTIMAL CASH BALANCE –

If a firm maintains a small cash balance, it has to sell its marketable securities more frequently than if it holds a large cash balance. Hence trading or transaction costs will tend to diminish if cash balance becomes larger. However, the opportunity costs of maintaining cash rise as the cash balance increases.

From the figure, the total costs of holding cash are at a minimum when the size of the cash balance is C . This represents optimal cash balance.

Deployment of surplus funds:

Company's often have surplus funds for short period of time before they are required for capital expenditure, loan repayment or some other purposes.

DEBTORS MANAGEMENT.

Assessing the credit worthiness of customers

Before extending credit to a customer, a supplier should analyze the five Cs of credit worthiness, which will provoke a series of questions. These are:

- **Capacity:** will the customer be able to pay the amount agreed within the allowable credit period? What is their past payment record? How large is the customer's business capital. what is the financial health of the customer? Is it a liquid and profitable concern, able to make payments on time?
- **Character:** do the customers management appear to be committed to prompt payment? Are they of high integrity? What are their personalities like?
- **Collateral:** what is the scope for including appropriate security in return for extending credit to the customer?
- **Conditions:** what are the prevailing economic conditions? How are these likely to impact on the customers ability to pay promptly?
- **Bank references.** These may be provided by the customers bank to indicate their financial standing. However, the law and practice of banking secrecy determines the way in which banks respond to credit enquiries, which can render such references uninformative, particularly when the customer is encountering financial difficulties.
- **Trade references.** Companies already trading with the customer may be willing to provide a reference for the customer. This can be extremely useful, providing that the companies approached are a representative sample of all the clients' suppliers. Such references can be misleading, as they are usually based on direct credit

experience and contain no knowledge of the underlying financial strength of the customer.

- **Financial accounts.** The most recent accounts of the customer can be obtained either direct from the business, or for limited companies, from Companies House. While subject to certain limitations past accounts can be useful in vetting customers. Where the credit risk appears high or where substantial levels of credit are required, the supplier may ask to see evidence of the ability to pay on time. This demands access to internal future budget data.
- **Personal contact.** Through visiting the premises and interviewing senior management, staff should gain an impression of the efficiency and financial resources of customers and the integrity of its management.
- **Credit agencies.** Obtaining information from a range of sources such as financial accounts, bank and newspaper reports, court judgments, payment records with other suppliers, in return for a fee, credit agencies can prove a mine of information. They will provide a credit rating for different companies. The use of such agencies has grown dramatically in recent years.
- **Past experience.** For existing customers, the supplier will have access to their past payment record. However, credit managers should be aware that many failing companies preserve solid payment records with key suppliers in order to maintain supplies, but they only do so at the expense of other creditors. Indeed, many companies go into liquidation with flawless payment records with key suppliers.
- **General sources of information.** Credit managers should scout trade journals, business magazines and the columns of the business press to keep abreast of the key factors influencing customers' businesses and their sector generally. Sales staffs who have their ears to the ground can also prove an invaluable source of

information.

- **Credit terms granted to customers**
- Although sales representatives work under the premise that all sales are good (particularly, one may add, where commission is involved!), the credit manager must take a more dispassionate view. They must balance the sales representative's desire to extend generous credit terms, please customers and boost sales, with a cost/benefit analysis of the impact of such sales, incorporating the likelihood of payment on time and the possibility of bad debts. Where a customer does survive the credit checking process, the specific credit terms offered to them will depend upon a range of factors. These include:
 - **Order size and frequency:** companies placing large and/or frequent orders will be in a better position to negotiate terms than firms ordering on a one-off basis.
 - **Market position:** the relative market strengths of the customer and supplier can be influential. For example, a supplier with a strong market share may be able to impose strict credit terms on a weak, fragmented customer base.
 - **Profitability:** the size of the profit margin on the goods sold will influence the generosity of credit facilities offered by the supplier. If margins are tight, credit advanced will be on a much stricter basis than where margins are wider.
 - **Financial resources of the respective businesses:** from the supplier's perspective, it must have sufficient resources to be able to offer credit and ensure that the level of credit granted represents an efficient use of funds. For the customer, trade credit may represent an important source of finance, particularly where finance is constrained. If credit is not made available, the customer may switch to an alternative, more understanding supplier.
 - **Industry norms:** unless a company can differentiate itself in some manner (e.g., unrivalled after sales service), its credit policy will

generally be guided by the terms offered by its competitors. Suppliers will have to get a feel for the sensitivity of demand to changes in the credit terms offered to customers.

- **Business objectives:** where growth in market share is an objective, trade credit may be used as a marketing device (i.e., liberalized to boost sales volumes).

The main elements of a trade policy are:

- **Terms of trade:** the supplier must address the following questions: which customers should receive credit? How much credit should be advanced to particular customers and what length of credit period should be allowed?
- **Cash discounts:** suppliers must ponder on whether to provide incentives to encourage customers to pay promptly. A number of companies have abandoned the expensive practice of offering discounts as customers frequently accepted discounts without paying in the stipulated period.
- **Collection policy:** an efficient system of debt collection is essential. A good accounting system should invoice customers promptly, follow up disputed invoices speedily, issue statements and reminders at appropriate intervals, and generate management reports such as an aged analysis of debtors. A clear policy must be devised for overdue accounts, and followed up consistently, with appropriate procedures (such as withdrawing future credit and charging interest on overdue amounts). Materiality is important. Whilst it may appear nonsensical to spend time chasing a small debt, by doing so, a company may send a powerful signal to its customers that it is serious about the application of its credit and collection policies. Ultimately, a balance must be struck between the cost of implementing a strict collection policy (i.e., the risk of alienating otherwise good customers) and the

tangible benefits resulting from good credit management

Problems in collecting debts

Despite the best efforts of companies to research the companies to whom they extend credit, problems can, and frequently do, arise. These include disputes over invoices, late payment, deduction of discounts where payment is late, and the troublesome issue of bad debts. Space precludes a detailed examination of debtor finance, so this next section concentrates solely on the frequently examined method of factoring.

Factoring an evaluation

Key elements:

Factoring involves raising funds against the security of a company's trade debts, so that cash is received earlier than if the company waited for its credit customers to pay. Three basic services are offered, frequently through subsidiaries of major clearing banks:

- Sales ledger accounting, involving invoicing and the collecting of debts;
- Credit insurance, which guarantees against bad debts;
- Provision of finance, whereby the factor immediately advances about 80% of the value of debts being collected.

There are two types of factoring service:

Non-recourse factoring is where the factoring company purchases the debts without recourse to the client. This means that if the clients debtors do not pay what they owe, the factor will not ask for his money back from the client.

Recourse factoring, on the other hand, is where the business takes the bad debt risk. With 80% of the value of debtors paid up front (usually electronically into the clients bank account, by the next working day), the remaining 20% is paid over when either the debtors pay the factor (in the case of recourse factoring), or, when the debt becomes due (non-recourse factoring). Factors usually charge for their services in two ways: administration fees and finance charges. Service fees typically range from 0.5 - 3% of annual turnover. For the finance made available, factors levy a separate charge, similar to that of a bank overdraft.

Advantages

- provides faster and more predictable cash flows;
- finance provided is linked to sales, in contrast to overdraft limits, which tend to be determined by historical balance sheets;
- growth can be financed through sales, rather than having to resort to external funds;
- the business can pay its suppliers promptly (perhaps benefiting from discounts) and because they have sufficient cash to pay for stocks, the firm can maintain optimal stock levels;
- management can concentrate on managing, rather than chasing debts;
- the cost of running a sales ledger department is saved and the company benefits from the expertise (and economies of scale) of the factor in credit control

Disadvantages

- the interest charge usually costs more than other forms of short-term debt;
- the administration fee can be quite high depending on the number of debtors, the volume of business and the complexity of the accounts;
- By paying the factor directly, customers will lose some contact with the supplier. Moreover, where disputes over an invoice arise, having the factor in the middle can lead to a confused three-way communication system, which hinders the debt collection process;
- Traditionally the involvement of a factor was perceived in a negative light (indicating that a company was in financial difficulties), though attitudes are rapidly changing.

Conclusion:

Working capital management is of critical importance to all companies. Ensuring that sufficient liquid resources are available to the company is a pre-requisite for corporate survival. Companies must strike a balance between minimizing the risk of insolvency (by having sufficient working capital) with the need to maximize the return on assets, which demands a far less conservative outlook.

CREDITORS MANAGEMENT MANAGING PAYABLES (CREDITORS)

Creditors are a vital part of effective cash management and should be managed carefully to enhance the cash position.

Purchasing initiates cash outflows and an over-zealous purchasing function can create liquidity problems. Consider the following:

- Who authorizes purchasing in your company - is it tightly managed or spread among a number of (junior) people?
- Are purchase quantities geared to demand forecasts?
- Do you use order quantities, which take account of stock holding and purchasing costs?
- Do you know the cost to the company of carrying stock?
- Do you have alternative sources of supply? If not, get quotes from major suppliers and shop around for the best discounts, credit terms, and reduce dependence on a single supplier.
- How many of your suppliers have a returns policy?
- Are you in a position to pass on cost increases quickly through price increases to your customers?
- If a supplier of goods or services lets you down can you charge back the cost of the delay?
- Can you arrange (with confidence!) to have delivery of supplies staggered or on a just-in-time basis?

INVENTORY MANAGEMENT

Managing inventory is a juggling act. Excessive stocks can place a heavy burden on the cash resources of a business. Insufficient stocks can result in lost sales, delays for customers etc.

The key is to know how quickly your overall stock is moving or, put another way, how long each item of stock sit on shelves before being sold.

Obviously, average stock-holding periods will be influenced by the nature of the business. For example, a fresh vegetable shop might turn over its entire stock every few days while a motor factor would be much slower as it may carry a wide range of rarely-used spare parts in case somebody needs them.

Nowadays, many large manufacturers operate on a Just-In-Time (JIT) basis whereby all the components to be assembled on a particular today, arrive at the factory early that morning, no earlier - no later. This helps to minimize manufacturing costs as JIT stocks take up little space, minimize stock holding and virtually eliminate the risks of obsolete or damaged stock. Because JIT manufacturers hold stock for a very short time, they are able to conserve substantial cash. JIT is a good model to strive for as it embraces all the principles of prudent stock management.

The key issue for a business is to identify the fast and slow stock movers with the objectives of establishing optimum stock levels for each category and, thereby, minimize the cash tied up in stocks.

Factors to be considered when determining optimum stock levels include:

- What are the projected sales of each product?
- How widely available are raw materials, components etc.?

Profit and Loss A/C

Particular Year	Amount (Rs.lacs)	Amount (Rs.lacs)	Amount (Rs.lacs)	Amount (Rs.lacs)	Amount (Rs.lacs)	Amount (Rs.lacs)
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
(A) INCOME						
Sales	17058.47	19360.52	21624.68	26414.22	30365.16	33693.00
Add. Other Income	<u>2633.59</u>	<u>683.91</u>	<u>835.02</u>	<u>621.45</u>	<u>736.58</u>	<u>557.65</u>
Total Income	19691.06	20044.43	22459.72	27035.67	31101.75	34250.65
(B) EXPENDITURE						
Materials Consumed:-						
Materials Consumed:	8870.04	10866.21	12412.56	15817.46	17573.95	
Stores & spaces consume:	505.99	593.58	688.84	895.23	1116.39	
WIP & finish goods	<u>223.94</u>	<u>192.63</u>	<u>-380.95</u>	<u>-120.27</u>	<u>-188.12</u>	
	9599.97	11652.42	12720.45	16592.42	18502.22	20215.82
Manufacturing Expenses:	1636.51	1424.12	1443.96	1913.07	3250.81	2526.97
Employee's Emoluments:	3597.64	3115.99	3336.03	3681.32	3598.01	4007.77
Interest & other Fin. Charges	1458.91	852.9	587.35	521.05	488.42	346.37
Sundry Expenses:	4037.1	2722.47	4060.27	3946.17	4718.76	5084.25
Depreciation:	<u>277.49</u>	<u>223.68</u>	<u>214.74</u>	<u>225.8</u>	<u>249.37</u>	<u>260</u>
Total Expenditure	20607.62	19991.58	22362.8	26879.83	30807.59	32441.16

Net Profit before Tax (A-B)	-916.56	52.85	96.92	155.84	294.16	1809.49
Provision for Tax	<u>2.2</u>	<u>6.08</u>	<u>1.75</u>	<u>3.03</u>	<u>82</u>	<u>597.13</u>
Net Profit After Tax	-918.76	46.77	95.17	152.81	212.16	1212.36

BALANCE SHEET

A	SOURCES OF FUNDS:	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
1	Shareholders funds:						
	a) Capital	128422345	128443380	128443380	128443380	128443380	128443380
	b) Reserve & Surplus	203935113	207620112	216184117	230239120	335195910	457620000
2	Loan Funds:						
	a) Secured loans	663645876	640463151	581576924	514380917	380016497	391862000
	b) Unsecured loans	106008244	97272888	78335147	27727313	20376994	13285000
	TOTAL	1102011578	1073799531	1004539568	900790730	864032781	991210380
B	APPLICATION OF FUNDS:						
1	Fixed asset:						
	a) Gross Block	749985197	745342117	717930907	718557289	777226949	777226949
	b) Less-Depreciation	529139497	542178336	537061079	524722052	533470985	575222000
	Net block	220845700	203163781	180869828	193835237	243755964	202004949
	Capital WIP exp. To date	2764184	2764184	2764184	4723646	6384589	NIL
	Total	223609884	205927965	183634012	198558883	250140553	202004949
2	Technical Know-how		9816315	30106210	27037298	23968386	20799000
3	Investment	72534904	61043727	55600632	42967882	36106881	36106881

4	Current Asset, Loans & Advances						Contd
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	1) Inventories	309469261	294045465	429724069	418963322	366814500	40124700 0
	2) Sundry Debtors	849477102	875751450	884099843	897711768	904486832	93805300 0
	3) Cash & Bank balance	22043337	26143472	8159330	5590022	74504328	801369
	4) Loans & advances	342161013	303263771	195816844	139006705	120658554	12380000 0
	Less - Current Liabilities & provisions						
	1) Liabilities	820733336	774132429	842943606	860236799	918023088	72540000 0
	2) Provisions	17812993	17600025	175000	303000	15620580	16700000
	Net Current Assets	684604384	707471704	674681480	600732018	532820546	72180136 9
5	Miscellaneous Expenditure (To the extent not written off or adjusted)						
	Deferred revenue expenditure in respect of VRS	118562406	89539820	60517234	31494649	20996415	10498181
	Pension scheme	2700000	NIL	NIL	NIL	NIL	NIL
	TOTAL	110201157 8	107379953 1	100453956 8	900790730	864032781	99121038 0

Statement of changes in working capital (2017-18).

Particulars	2017-18	2018-19	Increase	Decrease
A) Current Assets				
a) Inventories	3094.70	2940.45		154.25
b) Sundry debtors	8494.77	8757.51	262.74	
c) Cash and bank	220.43	261.43	41.00	
d) Loans & advances	3421.61	3032.66		388.95
Total Current Assets	15231.50	14992.03		
B) Current Liabilities				
a) Sundry creditors	8207.33	7741.32	466.01	
b) Provisions.	178.12	176.00	2.12	
Total Current Liabilities	8385.46	7917.32		
Net Current Assets	6846.04	7074.71		
Decrease in working capital			771.87	543.20
	228.67			228.67

Statement of changes in working capital (2017-18).

Particulars	2017-18	2018-19	Increase	Decrease
A) Current Assets				
a) Inventories	2940.45	4297.24	1356.79	
b) Sundry debtors	8757.51	8841	83.49	
c) Cash and bank	261.43	81.59		179.84
d) Loans & advances	3032.64	1958.17		1074.47
Total Current Assets	14992.03	15178.00		
B) Current Liabilities				
a) Sundry creditors	7741.32	8429.44		688.12
b) Provisions.	176.00	1.75	174.25	
Total Current Liabilities	7917.32	8431.19		
Net Current Assets	6560.94	6746.81		
Decrease in working capital			1614.53	1942.43
		327.9	327.9	

Interpretation:

This statement shows the decrease in Working Capital in the year 2018-19 by decrease in cash & bank balance & loans & advances.

Statement of changes in working capital (2018-19).

Particulars	2018-19	2019-20	Increase	Decrease
A) Current Assets				
a) Inventories	4297.24	4189.63		107.61
b) Sundry debtors	8841	8977.12	136.12	
c) Cash and bank	81.59	55.9		25.69
d) Loans & advances	1958.17	1390.07		568.1
Total Current Assets	15178.00	14612.72		
B) Current Liabilities				
a) Sundry creditors	8429.44	8602.37		172.93
b) Provisions.	1.75	3.03		1.28
Total Current Liabilities	8431.19	8605.4		
Net Current Assets	6746.81	6007.32		
			136.12	875.61
Decrease in working capital		739.49	739.49	

Interpretation:

The statement shows the decrease in Working Capital in the year 2018-19 by decrease in cash & Bank balance, inventories, loans & advances.

Statement of changes in working capital (2020-21).

Particulars	2019-20	2020-21	Increase	Decrease
A) Current Assets				
a) Inventories	4189.63	3668.14		521.49
b) Sundry debtors	8977.12	9044.86	67.74	
c) Cash and bank	55.9	745.04	689.14	
d) Loans & advances	1390.07	1206.58		183.49
Total Current Assets	14612.72	14664.64		
B) Current Liabilities				
a) Sundry creditors	8602.37	9180.23		577.86
b) Provisions.	3.03	156.20		153.17
Total Current Liabilities	8605.4	9336.43		
Net Current Assets	6007.32	5328.20		
			756.88	1436.01
Decrease in working capital		679.12	679.12	

Interpretation:

This statement shows the increase in Working Capital in the year 2020-21 by increase in cash & bank balance, inventories & debtors. In the final analyses

Projection of changes in working capital (2020-21).

Particulars	2019-20	2020-21	Increase	Decrease
A) Current Assets				
a) Inventories	3668.14	4012.47	344.33	
b) Sundry debtors	9044.86	9280.53	235.67	
c) Cash and bank	745.04	108.02		637.02
d) Loans & advances	1206.58	1238.00	31.42	
Total Current Assets	14664.64	14639.01		
B) Current Liabilities				
a) Sundry creditors	9180.23	7254.00	1926.23	
b) Provisions.	156.20	167.00		10.80
Total Current Liabilities	9336.43	7421.00		
Net Current Assets	5328.21	7218.01		
			2537.65	647.82
Increase in working capital	1889.81			1889.81

Statement showing Net Current Assets / Net Working Capital

Particulars	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
A] C. Assets						
a) Inventories	3094.70	2940.45	4297.24	4189.63	3668.14	4012.47
b) S. Debtors	8494.77	8757.51	8841	8977.12	9044.86	9280.53
c) Cash & bank balance.	220.43	261.43	81.59	55.9	745.04	108.01
d) Loans & Advances	3421.61	3032.64	1958.17	1390.07	1206.58	1238.00
Total Amt.	15231.50	14992.03	15178	14612.72	14664.64	14639.01
B] C. Liabilities						
a) Creditors	8207.33	7741.32	8429.44	8602.37	9180.23	7254.00
b) Provisions	178.12	176	1.75	3.03	156.20	167.00
Total Amt.	8385.46	8431.19	8431.19	8605.4	9336.43	7241.00
Net Current liabilities [A-B]	6846.04	6606.57	6746.81	6007.32	5328.20	7398.01

Interpretation:

This table shows the Working Capital position for the last 5 years & the projected Working Capital for 2020-21.

FINDINGS

- 1) Defence sales order of Rs. 9 cr was not there for the first quarter of 2020-21, so the sales hasdecreased.
- 2) Debtors of the company were high; they were increasing year by year, so more funds were blocked in debtors. But now recovery is becoming faster.
- 3) Production capacity is not utilized to the fullextent

SUGGESTIONS

- 1) It can be said that overall financial position of the company is normal but it is required to be improved from the point of view of profitability.
- 2) Net operating cycle is increasing that means there is a need to make improvements in receivables/debtors management.
- 3) Company should stretch the credit period given by the suppliers.
- 4) Company should not rely on Long-term debts.
- 5) Company should try to increase Volume based sales so as to stand in the competition.

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