

What is working capital management?

- Working capital management is concerned with the problems that arise in attempting to manage the current assets, the current liabilities and the inter-relations that exist between them.
- Current assets refer to those assets which in the ordinary course of business can be, or will be, converted into cash within one year without undergoing a diminution in value and without disrupting the operations of the firm.
- Current liabilities are those liabilities which are intended, at their inception, to be paid in the ordinary course of business, within a year, out of the current assets or the earnings of the concern.
- The goal of working capital management is to manage the firm's current assets and current liabilities in such a way that a satisfactory level of working capital is maintained.

Concepts of Working Capital

There are two concepts of working capital:

1. **Gross working capital-** It means the total current assets.
2. **Net working capital-** It can be defined in two ways:
 - a. The difference between current assets and current liabilities.
 - b. The portion of current assets which is financed with long term funds.

Types of working capital

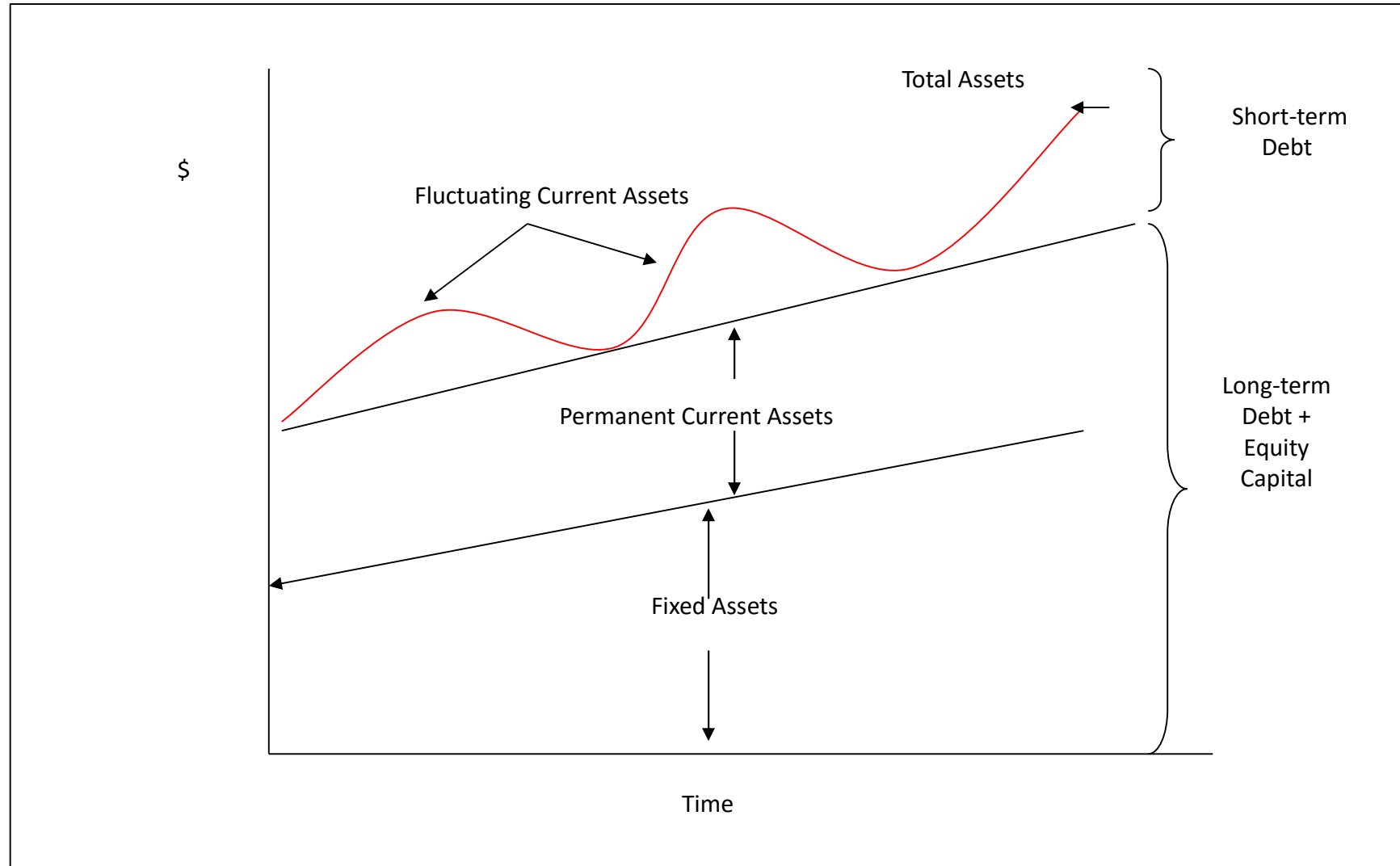
- The working capital need can be categorised into two parts:
 1. **Permanent working capital:**
 - There is always a minimum level of working capital which is continuously required by a firm in order to maintain its activities like cash, stock and other current assets in order to meet its business requirements irrespective of the level of operations.
 2. **Temporary working capital:**
 - Over and above the permanent working capital, the firm may also require additional working capital in order to meet the requirements arising out of fluctuations in sales volume. This extra working capital needed to support the increased volume of sales is known as temporary or fluctuating working capital.

Working Capital Financing

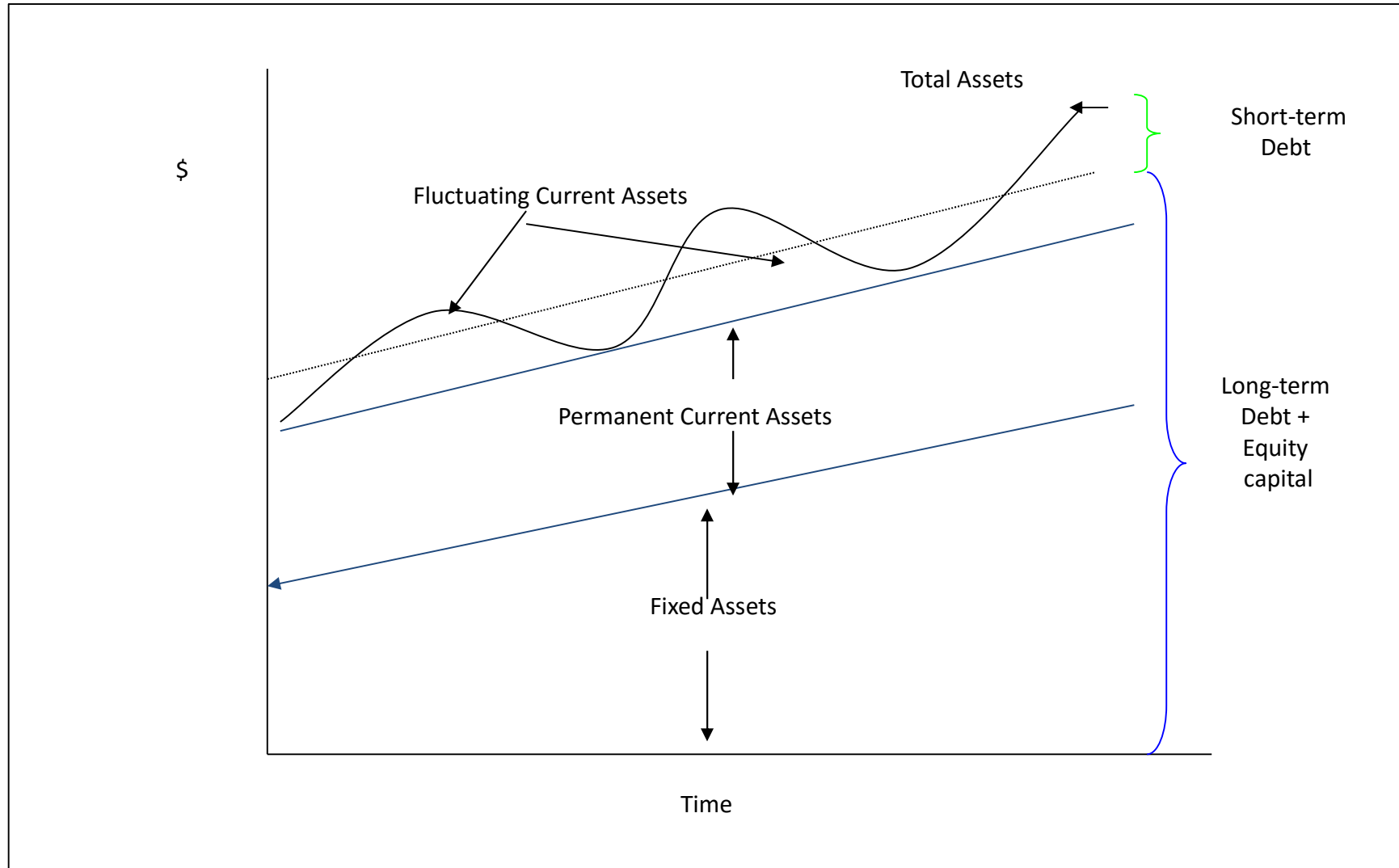
There are three basic approaches to determine an appropriate financing mix:

- Hedging approach, also called the matching approach,
- Conservative approach,
- Aggressive approach.

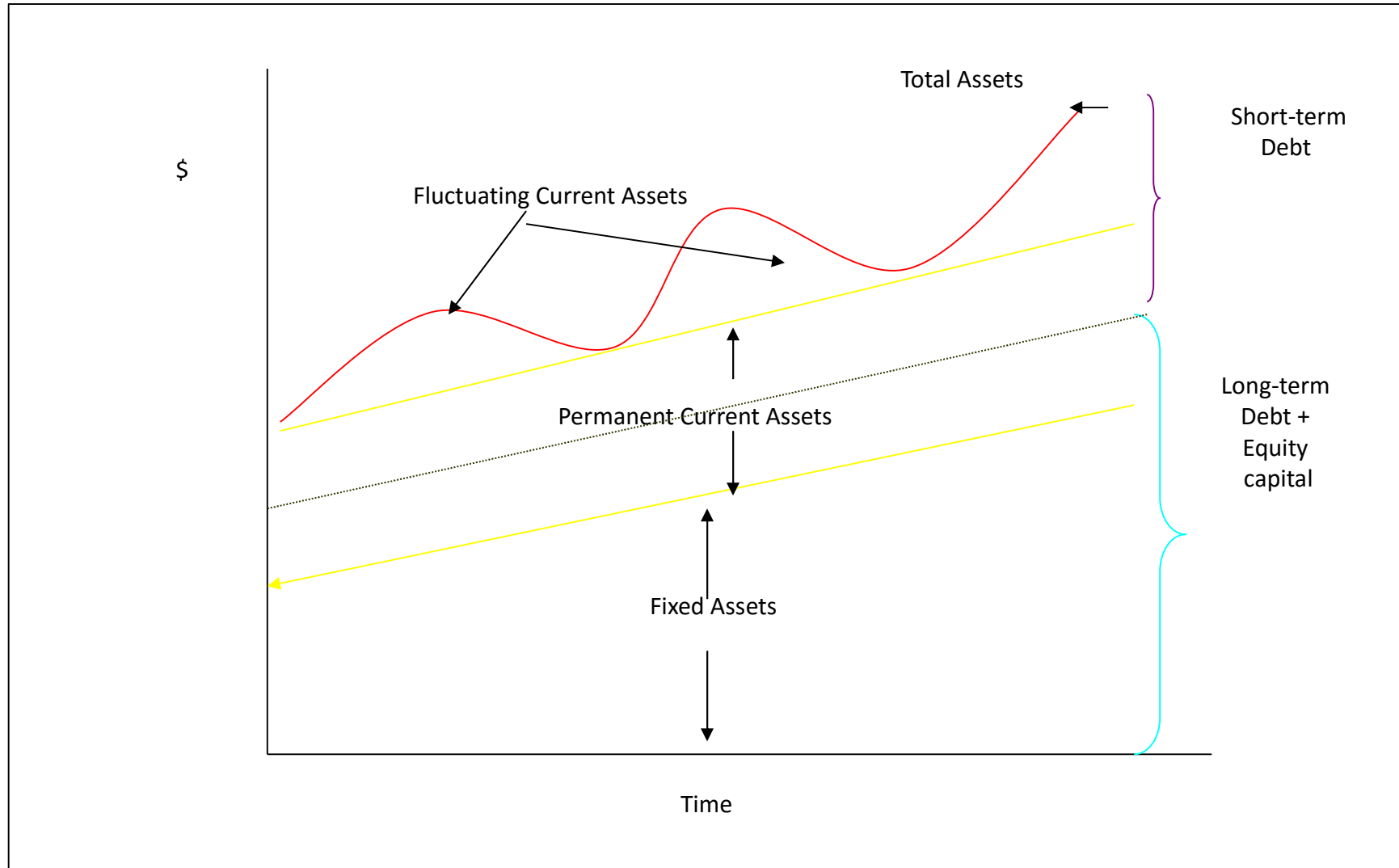
Matching approach to asset financing



Conservative approach to asset financing



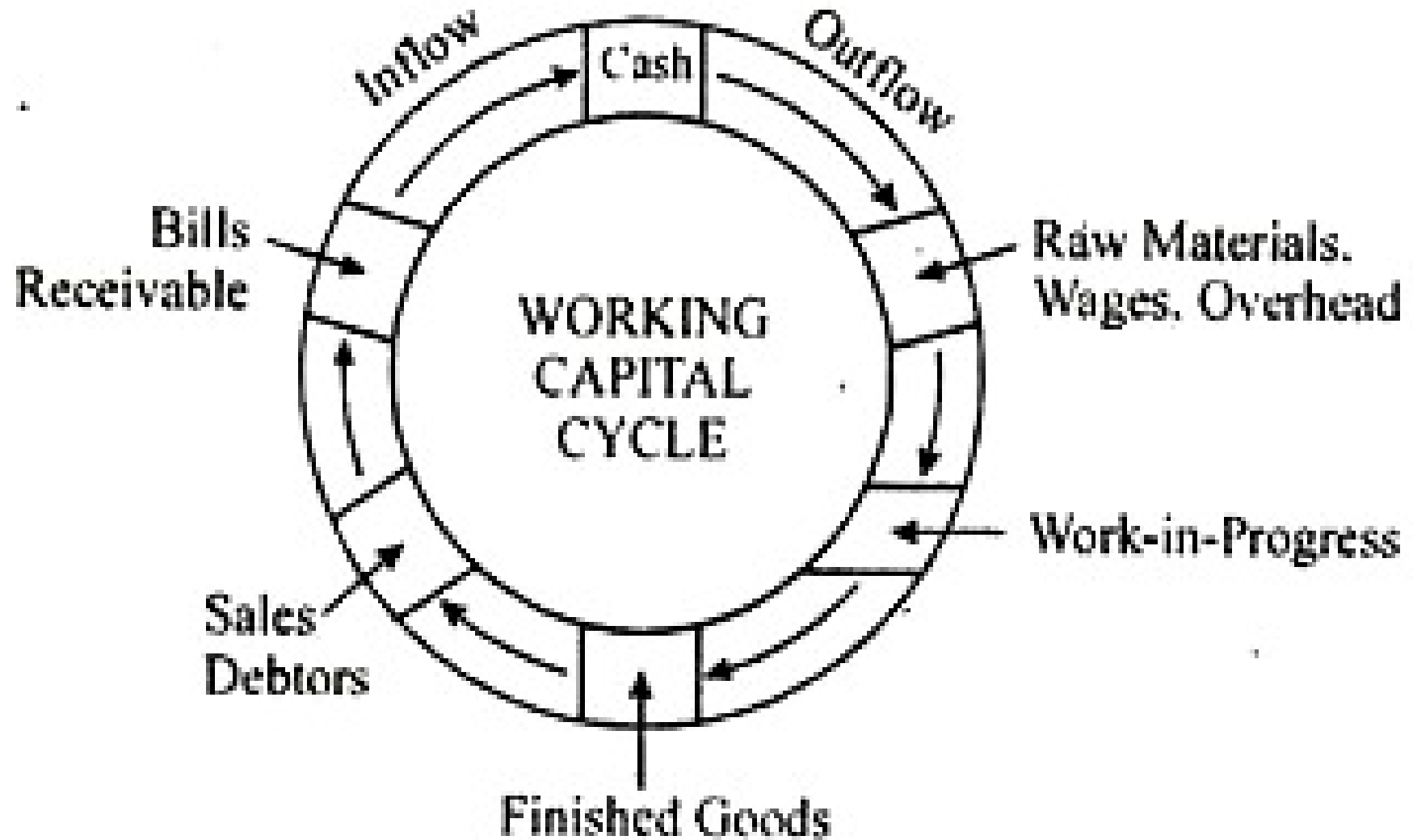
Aggressive approach to asset financing



Determinants of Working capital

- Nature of the business
- Production cycle
- Business cycle
- Production policy
- Growth and expansion
- Profit level
- Price level changes

Working Capital Cycle



Methods of Working Capital Assessment

1. Operating Cycle Method
2. Drawing Power Method
3. Turnover Method (Originally suggested by Naik Committee for SSI units)
4. Maximum Permissible Banking Finance (MPBF) Method (Tandon's Committee II method of lending)
5. Cash Budget method