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Management of Working Capital for an Enterprise

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ABSTRACT

Management of these short term assets and liabilities warrants a careful investigation, since the working capital management plays an important role in a firm's profitability and risk as well as its value (smith, 1980). This paper firstly defines the concept, purpose, scope, types / kinds and components of Working Capital Management (WCM). Secondly, it analyzes that Working Capital Management (WCM) should not be excessive and inadequate as both are harmful to the business. Excessive and inadequate Working Capital Management (WCM) is dangerous for the components as well. So, we can say that working capital of an enterprise should be optimal.

1. CONCEPT

Financial management decisions are divided into the management of assets (investments) and liabilities (sources of financing), in the long-term and the short-term. It is common knowledge that a firm's value cannot be maximized in the long run unless it survives the short run. Working Capital is the amount of funds necessary to cover the cost of operating the enterprise. Working capital management refers to the management of current or short-term assets and short-term liabilities. Components of short-term assets include inventories, loans and advances, debtors, investments and cash and bank balances. Short-term liabilities include creditors, trade advances, borrowings and provisions. Firms fail most often because they are unable to meet their working capital needs; consequently, sound working capital management is a requisite for firm survival.

About 60 percent of a financial manager's time is devoted to working capital management, and many of the potential employees in finance-related fields will find out that their first assignment on the job will involve working capital. In many text books working capital refers to current assets, and net working capital is defined as current assets minus current liabilities. Working capital policy refers to decisions relating to the level of current assets and the way they are financed, while working capital management refers to all those decisions and activities a firm undertakes in order to manage efficiently the elements of current assets.

Therefore, Working Capital Management (WCM) applied for short term financing or current assets and current liabilities which is helpful for day to day operations. A firm is required to invest in current assets for a smooth, uninterrupted production and sale. So, Working Capital is commonly defined as the difference between current assets and current liabilities.

Current Assets: The term 'Current Assets' refers to those assets which will be turned into cash with in current accounting period one year or within the next year as a result of the ordinary operations of the business. Current assets includes cash in hand and bank balances, bills receivables, sundry debtors, short-term loans and advances, inventories of stocks (Raw Materials, Work in progress, Finished goods), prepaid expenses, accrued incomes, temporary investments etc.

Current Liabilities: The term 'Current Liabilities' refer to those liabilities which have to be paid current accounting period or with in a year i.e. Bills payable, sundry creditors, accrued outstanding expenses, short term loans, advances and deposits, taxes and dividend payable, bank overdraft, provision for taxation etc.

2. SCOPE

The Scope of Working Capital has been increased to the great extent, in a global and complex business world; business can not be flourishing without Working Capital. Working Capital is the source of marketing at a large scale in this complex world through which each and every level of information can be taken with the place you suited the most even at your home.

3. COMPONENTS OF WORKING CAPITAL MANAGEMENT (WCM)

For the managing of Working Capital, we are required to manage the Working Capital Management (WCM) components. Components of short-term assets include inventories, loans and advances, debtors, investments and cash and bank balances. Short-term liabilities include creditors, trade advances, borrowings and provisions. It is important that companies minimize risk by prudent working capital management. The major components of working capital are :

a) Cash Management: Cash is the important current assets for the operation of the business. Cash is the basic input needed to keep the business running on a continuous basis; it is also the ultimate out put expected to be realized by selling the service or product manufactured by the firm. The firm should keep sufficient cash, neither more nor less. "Cash is the lifeblood of business" is an often repeated maxim amongst financial managers. Working capital management refers to the management of current or short-term assets and short-term liabilities.

b) Receivable Management: Receivable management is the process of making decision relating to investment in trade debtors. Certain investment in receivables is necessary to increase the sales and the profits of a firm. But at the same time investment in this asset involves cost consideration also. Further, there is always a risk of bad debts too. Thus, the objective of receivable management is to take sound decision as regards investment in debtors.

c) Inventory Management: The investment in inventory is very high in most of the undertakings engaged manufacturing, wholesale and retail trade. The purpose of inventory management is to keep the stocks in such a way that neither there is over stocking nor under stocking. A proper planning of purchasing, handling, storing and accounting should from a part of inventory management.

4. INADEQUACY AND EXCESSIVE OF THE WORKING CAPITAL

Every business concern should have adequate working capital to run its business operations. It should have neither inadequate or shortage of working capital nor redundant or excess working capital. Both excess as well as short working capital positions are bad for any business. For smooth functioning of the business, we have to manage working capital. The consideration of the level of investment in current assets should avoid two danger points:

a) Inadequacy of the Working Capital: Inadequacy of the working capital can threaten solvency of the firm. It is not capable to complete day to day operational activities. So, there is a chance of insolvency. A concern which has inadequate working can not play its short-term liabilities in time. Thus, it will loss its reputation and shall not be able to get good credit facilities. The firm can not pay day to day expenses of its operations and it creates inefficiencies

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increases costs and reduces the profits of the business. Inadequacy also creates loss of Goodwill, difficulties to business operations.

(a) Inadequacy of the cash disrupts the firm's manufacturing operations.
(b) Inadequacy of Receivables (debtors) result of unable to avail attractive credit opportunities.
(c) Inadequacy of inventories (stock) results of stoppage of work.

b) Excessive of the Working Capital: Excessive Working Capital means idle funds which earn no profits for the business. When there is excessive Working Capital, relations with banks and other financial institutions may not be maintained. It also gives rise to speculative transactions.

(a) Excessive of Cash result of loss, theft of cash as well as simply remain idle, without contributing anything towards the firm's profitability.
(b) Excessive of Receivables (debtors) result of Bad debts, increase in the opportunity cost that is money block cost.
(c) Excessive of inventories (stock) result of mishandling, waste, chance of theft, obsolesce of the inventory, reduction of liquidity and starving to other production processes.

Investment in current assets should be just adequate, not more, not less, to the needs of the business firm. Investment in current assets should be avoided because it impairs firm's probability, loss of interest, loss of opportunity cost.

5. CONCLUSION

Adequacy or inadequacy of these funds would determine the efficiency with which the daily business may be carried on. Management of working capital is an essential task of the finance manager. He has to ensure that the amount of working capital available with his concern is neither large nor small for its requirements. Management of current assets, current liabilities and their relationship constitutes working capital management of an enterprise. A business organization has to be conscious that inadequate working capital can disrupt its operations leading illiquidity. At the same time excessive working capital is also not desirable since it adversely affects profitabiity.

There is a cute relationship between the Working Capital and business. It measurement is most appropriately desirable for the successful business. Efficient Working Capital Management (WCM) requires that the firms should operate with some amount of Working Capital, the exact amount varying from firm to firm and depending upon other things on the nature of industry. It should neither be excessive nor inadequate.

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