A Study of Working Capital Management in SSI–A Conceptual Framework

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Abstract

The role played by small business in the economic activity of Indian history since practically the beginning of the recorded time is significant. Small scale industries are the backbone of our industrial structure as they provide a variety of non-traditional, low technology products. They are also engaged in the processing, preserving, manufacturing & servicing activities and play a vital role in balanced and sustainable economic growth. Thus, a proper development of small scale industries is essential for the healthy growth of economy. Working capital typically means the firm's current or short-term assets such as cash, receivables, inventory and marketable securities. The capital of a business which is used in its day-by-day trading operations, calculated as the current assets minus the current liabilities. Working capital is also called operating assets or net current assets. Working capital management is concerned with the problems that arise in attempting to manage the current assets, the current liabilities and the interrelations that exist between them. Working capital management plays a vital role for small scale industries in their day to day operations. The decision of working capital management is an important aspect for small scale industries because management of current assets and current liabilities represented mainly by cash, inventories, bills receivables and bills payable is a continuous process. Working capital requirements differ widely depending on the length of the manufacturing cycle, market characteristics etc. Working capital needs are volatile in nature due to seasonal variations in sales.

Keywords : *Small Scale Industries, Working Capital, Working Capital Management, Current Assets, Current Liabilities.*

JEL Classification : *E 22, L 11, L 16, M 49.*

1. INTRODUCTION

Small scale industries are the lifeline of Indian industrial setup as they provide a variety of traditional, employment based and low technology products. They are also engaged in the processing, preserving, manufacturing and servicing activities and play a vital role in balanced and sustainable economic growth. The basic goal of government of India in developing small scale industries in rural areas is to provide better employment opportunities, to increase basic income levels and to raise standards of living of rural population. Therefore, Small Scale Industries are essential for providing boost to country is socio-economic development at a

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constant speed. Therefore, the development of small scale industries in India was necessary for the overall economic, social and industrial development of a country.

Furthermore, Working capital typically means the firm's current or short-term assets such as cash, receivables, inventory and marketable securities. The capital of a business which is used in its day-by-day trading operations, calculated as the current assets minus the current liabilities. Working capital is also called operating assets or net current assets. Working capital management is concerned with the problems that arise in attempting to manage the current assets, the current liabilities and the interrelations that exist between them. As we knew, current assets are those assets which can be, converted into cash within one year easily without a decrease in value and without disrupting the operations of the firm. For instance, cash, marketable securities, accounts receivable and inventory. Whereas, current liabilities are those liabilities that need to be paid in the ordinary course of business, within a year, incase or out of the current assets or the earnings of the organization. For example, it is possible to be mentioned accounts payable, bills payable, bank overdraft and outstanding expenses.

2. CONCEPTS OF WORKING CAPITAL

Working capital may be of two types.

a) **Gross working capital :** Refers to the firm's investment in the current assets and includes cash, short term securities, debtors, bills receivables and inventories. It is necessary to note here that the investment in the current assets should be balanced. It means that it should neither excessive nor inadequate.

b) **Net working capital :** It is a difference value between the current assets and the current liabilities.

Current liabilities are the claims by the providers of various resources to the firm, which are expected to mature for the payment within an accounting year, it may include creditors, bills payable, and other outstanding expenses. If current assets exceed current liabilities, it is called positive working capital and if current liabilities exceed current assets it is called negative working capital.

3. CLASSIFICATION OF SMALL SCALE INDUSTRIES

Small scale industries are classified into two main parts :

a) **Traditional sector**

i) Handicrafts ii) Handlooms iii) Khadi, village and Cottage industries iv) Coir v) Sericulture

b) **Modern sector**

i) Power loom, ii) Residual SSI

4. OBJECTIVE OF THE RESEARCH PAPER

The present research paper is based upon an assumption that SSIs need short terms working capital is set as objective of the present study.

5. WORKING CAPITAL NEEDS AND ITS DETERMINANT

Working Capital is required by a small scale industry because of various factors such as:

a) **Operating Cycle :** A small scale firm needs capital for its daily operations. Raw material is required for manufacturing. Therefore, firm requires holding up of raw material for production to finished product time gap. A firm needs cash for financing inventories, receivables and other business expenses.

b) **Manufacturing Cycle :** The size of working capital is also influenced by the length of the manufacturing cycle. Manufacturing cycle always involves a gestation period between the raw materials are fed in the production line and finished products are received.

c) **Nature of Business :** A firm's requirements of working capital funds are significantly determined by the nature of its business. Working capital requirements of the companies depend on a number of factors including nature of products, technology, and marketing policies.

d) **Economies of Scale :** Need for working capital is also influenced by a firm's desire to take advantage of the economies of scale.

e) **Current Assets :** Current Assents of a company can only determine the amount of working capital requirements.

6. TYPES OF WORKING CAPITAL MANAGEMENT

a) **Permanent Working Capital :** Permanents working capital is that fixed amount of worker capital which is required continuously by firm to carry on business operation smoothly.

b) **Variable Working Capital :** This working capital changes with the change in the amount of production and sales. It is the excess of working capital over and above the permanent working capital, that is required to support the extra production and sales activities. This type of working capital is also called as fluctuating or variable working capital.

7. WORKING CAPITAL APPROACHES

It can be explained by two approaches:

a) **Conservative approach :** A firm financing its common permanent assets and also with long term financing and less risky so far as insolvency is concerned. However funds may be invested in such investment which fetches small returns to build up liquidity.

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

b) **Aggressive approach :** The firm uses only short term financing. In this approach, the firm finances a part of the permanent assets with short term financing. This approach refers to more risky but may at returns to the assets.

Table 1.
Alternative Policies and Amount of Current Assets (Regarding SSI)

Units of Output	Current Assets		
	Conservative	Average	Aggressive
50000	35	30	27.5
100000	50	40	35

Source : Commissioner (SSI)

8. RISK- RETURN TRADE- OFF OF ALTERNATIVE FINANCING PLANS FOR SMALL SCALE INDUSTRIES

Financing decision involves a risk return trade off. Short term financing involves higher

Table 2.
Effects of Alternative Assets Policy on Profitability (Regarding SSI)

Particulars	Current Assets Policies		
	Aggressive	Average	Conservative
Sales (Units)	10000	10000	10000
Sales (Rs.)	6000000	6000000	6000000
Earnings Before Interest & Tax (EBIT)	1200000	1200000	1200000
Current Assets	3500000	4000000	5000000
Fixed Assets	2000000	2000000	2000000
Total Assets	5500000	6000000	7000000
Assets Turnover (Sales/ Total Assets)	1.09:1	1:1	.857:1
Current Assets/ Total Assets Ratio	.635	.667	.701
Rate of Return on assets (EBIT/Assets)	21.8%	20%	17.1%

Source : Commissioner (SSI)

profitability and also higher financial risk, whereas long term financing results in lower profitability as also lower financial risk. A firm needs funds for financing its fixed and current assets and it uses both long term as well as short term sources.

a) Hedging or Matching Policy

b) Aggressive Financing Policy

c) Conservative Financing Policy

Table 3.
Effect of Financing Policy on Return and Risk (Rs. In Lakhs)

Particulars	Conservative	Matching	Aggressive	Highly Aggressive
Fixed Assets	65	65	65	65
Current Assets Permanent: 20 Temporary: 15	35	35	35	35
Total Assets	**100**	**100**	**100**	**100**
Short term credit (7 per cent)	10	15	25	40
Long term credit (12 per cent)	25	20	10	-
Current Ratio	3.5:1	2.3:1	1.4:1	.9:1
EBIT	20	20	20	20
Less- Interest	3.70	3.55	2.95	2.80
Taxable Income	16.30	16.450	17.050	17.20
Less: Taxes	8.15	8.225	8.525	8.60
Earning on ordinary shares	**8.15**	**8.225**	**8.225**	**8.6**
Ordinary Share Capital	65	65	65	60
Return on Capital	**12.50**	**12.65**	**13.11**	**14.33**

Source : Commissioner (SSI)

9. CONCLUSION

Working capital typically means the firm's current or short-term assets such as cash, receivables, inventory and marketable securities. The capital of a business which is used in its day-by-day trading operations, is calculated as the excess of current assets over current liabilities. Working capital is also called operating assets or net current assets. Working capital management is basically concerned with the issues of the current assets, the current liabilities and the interrelations between these two. Working capital management plays a vital role for small scale industries in their day to day operations. Working capital management is an important concept for small scale industries to deal because these industries feel tender in the management of current assets and current liabilities on a continuous basis. A firm financing its common permanent assets and also with long term financing and less risky so far as insolvency is concerned. However funds may be invested in such investment which fetches small returns to build up liquidity. The firm uses only short term financing. In this approach, the firm finances a part of the permanent assets with short term financing. This approach refers to more risky but may at returns to the assets.

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