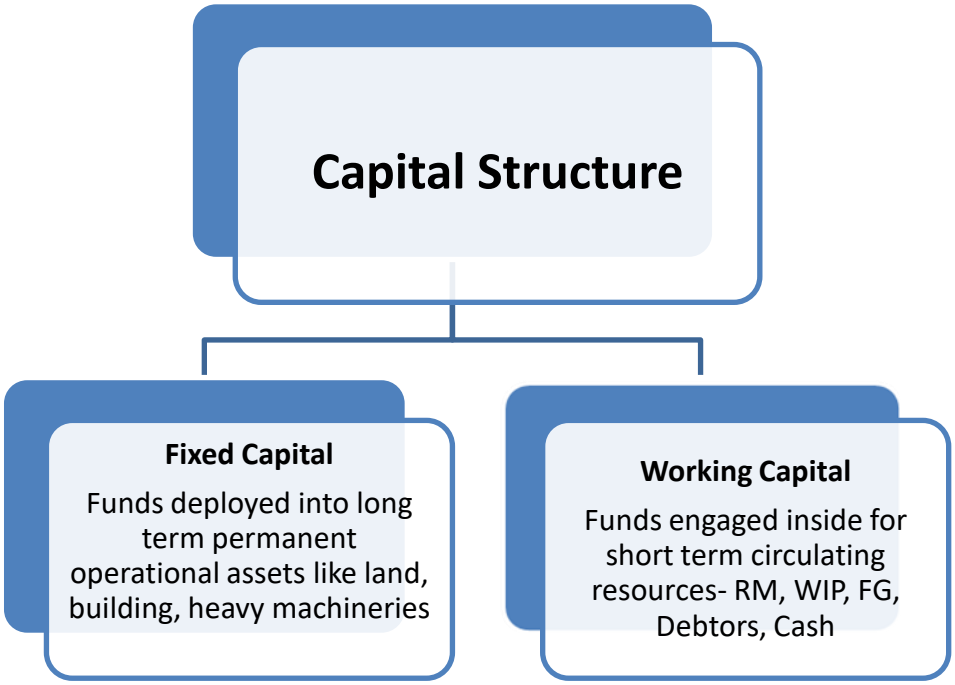
Unit: 1 Working Capital Management

1: FOUNDATIONAL THEORIES & CONCEPTUAL POLICIES

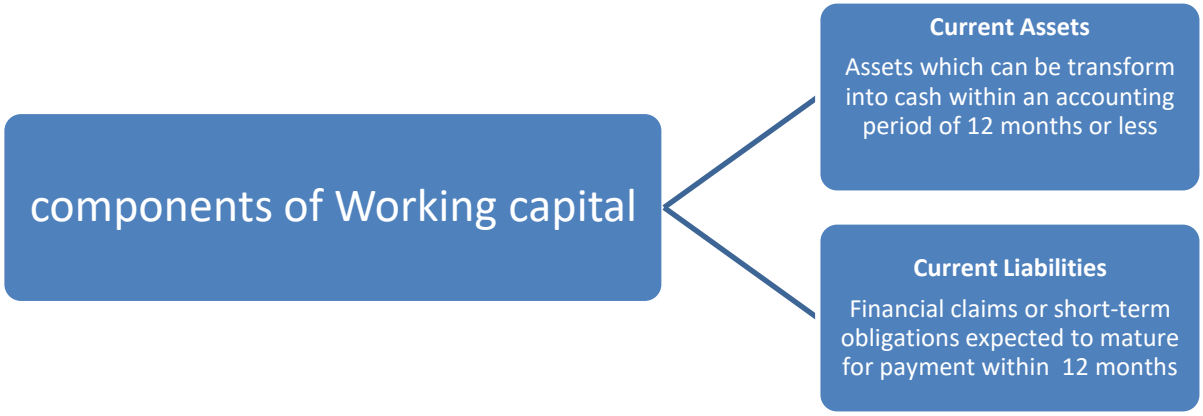
1. Introduction to Capital Structure

Primary Capital structure



2. Definition/ Meaning

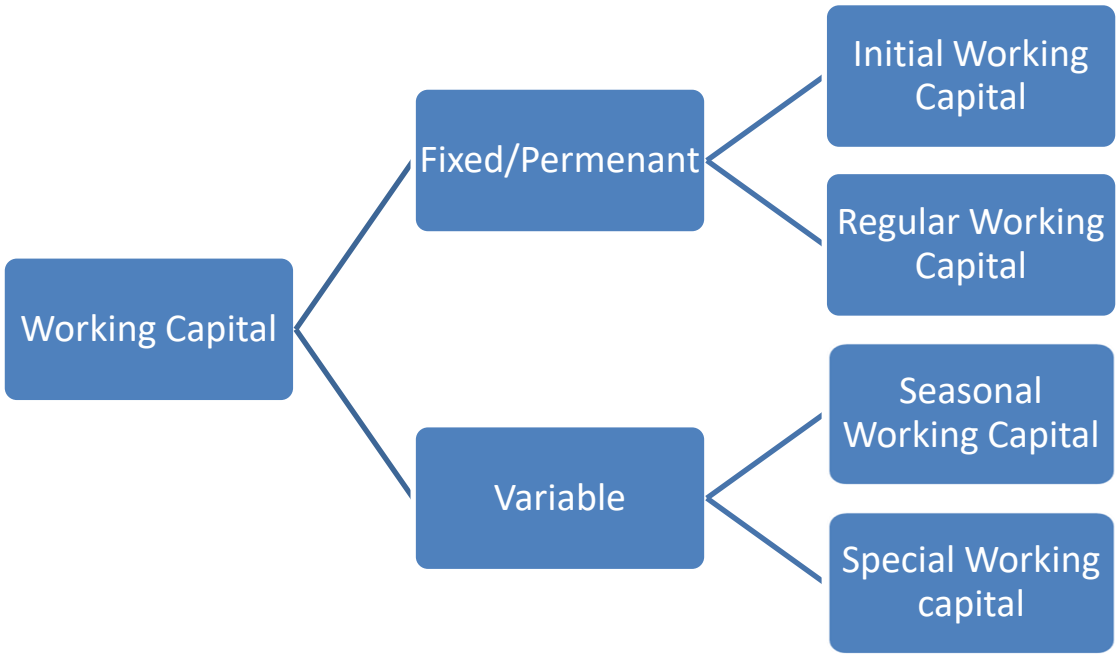
- **The "Life-Blood" of Business:** Working capital functions within a corporate structure exactly like the heart in a human body, maintaining continuous financial circulation A firm can survive temporarily without profits, but it cannot survive without liquidity. Two important components of Working capital are:



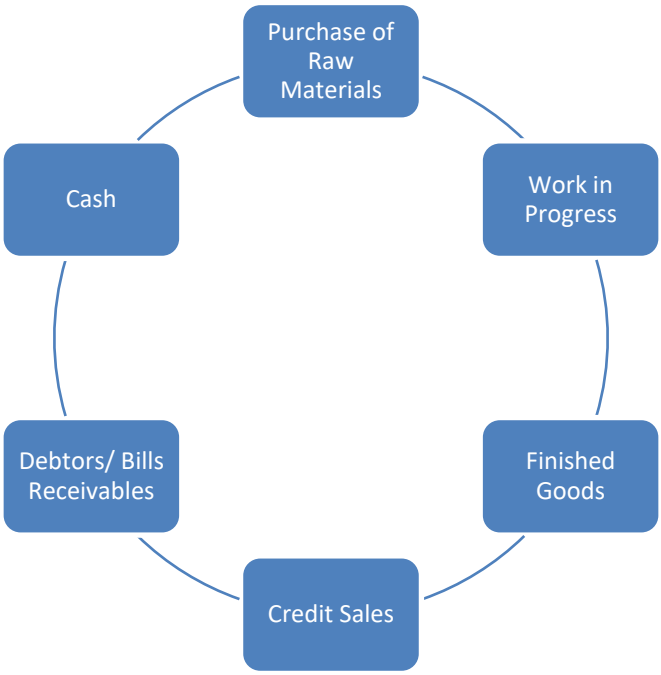
3. Quantitative vs. Qualitative concepts of Working capital

- **Gross Working Capital (Quantitative Concept):** Refers to the total sum investment in all current assets. It indicates the sheer size and extent of operational resources utilized by the company.
- **Net Working Capital (Qualitative Concept):** Defined strictly as the excess of Current Assets over Current Liabilities (CA - CL). It reflects short-term financial soundness, liquidity, and the company's capability to meet liabilities on time.

4. Types of Working Capital



Operating Cycle



5. Major Determinants of Working Capital Needs

1. **Nature of Business:** Public utilities (railways/electricity) collect cash upfront and need minimal working capital. Trading and retail houses carry diverse inventory and require heavy working capital cushions.
2. **The Production Cycle:** The longer it takes to process raw resources into finished inventory, the more capital remains locked in work-in-progress pipelines.
3. **Credit Terms & Policies:** If a company buys on immediate cash but sells on extended credit, its working capital requirements skyrocket. Favorable credit windows from vendors drop internal capital pressure down drastically.
4. **Macro Variables:** Rising inflation rapidly matches higher raw material and wage expenses, ballooning total cash demands. Corporate profit retention configurations and high dividend payouts strip out low-cost internal cash pools, triggering higher outside credit demands.

6. CORE FORMULAS of OPERATING CYCLE

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

1. **Raw material Storage Period= Average stock of Raw material/ Average consumption of RM *365**

Raw material consumed= Opening stock + Purchases- Closing stock

2. **Work in Progress period= Average stock of WIP/ Average production Cost*365**

Production Cost =Opening stock of WIP+RM consumed +wages +production expenses- closing stock of WIP

3. **Finished Goods Storage Period= Average stock of FG/ Average cost of Goods sold*365**

   Cost of Goods sold = Opening stock of FG +Production cost+ closing stock of FG

4. **Debtors collection Period= Average Debtors/ Average Sales*365**

5. **Creditors Payment Period= Average creditors/ Average Purchases*365**

Pro forma of Statement of Working Capital Management

Particulars	Amount	Amount
A. CURRENT ASSETS		
1. **Stock of Raw Materials** *(Average holding period)*	XX	
2. **Stock of Work-in-Progress (WIP)** *(Value of Material + Labor + Overheads)*	XX	
3. **Stock of Finished Goods** *(Cost of production × holding period)*	XX	
4. **Sundry Debtors / Receivables** *(Credit sales × credit period)*	XX	

5. **Advance Payments** *(Prepaid expenses like insurance or rent)*	XX	
6. **Cash and Bank Balances** *(Minimum required cash for daily operations)*	XX	
Gross Working Capital (Total Current Assets)		**XXXX**
B. CURRENT LIABILITIES		
1. **Sundry Creditors** *(Raw material purchases × credit period)*	XX	
2. **Lag in Payment of Wages / Labor** *(Outstanding wages)*	XX	
3. **Lag in Payment of Overheads** *(Outstanding administrative/factory expenses)*	XX	
Total Current Liabilities		**(XXXX)**
C. NET WORKING CAPITAL (A - B)		**XXXX**
Add: Provision for Contingencies (Usually a percentage of Net Working Capital)		XX
NET WORKING CAPITAL REQUIRED		**XXXX**