SYLLABUS

B.B.A. V SEM

Subject – Working Capital Management

UNIT – I	Principles of Working capital: Introduction to Working capital, Concept of' Working Capital
UNIT – II	Need for Working capital, Concepts and its determinants, estimation of working capital needs.
- III	Acco[illegible] ctoring: Fed[illegible] P[illegible] of individual a[illegible] ng: [illegible]es and be[illegible]
	[illegible] Nature of Inv[illegible] ive of in[illegible] techniques, [illegible]
	Manage[illegible]ent: P[illegible] Moti[illegible] olding cas[illegible] and [illegible]st[illegible]rse[illegible] vesting [illegible] e se[illegible]rities, cash[illegible] W[illegible] rad[illegible] Credit[illegible]

UNIT-I & II

INTRODUCTION:

The uses of funds of a concern can be divided into two parts namely long-term funds and short-term funds. The long – term investment may be termed as 'fixed investment.' A major part of the long-term funds is invested in the fixed assets. These fixed assets are retained in the business to earn profits during the life of the fixed assets. To run the business operations short–term assets are also required.

The term working capital is commonly used for the capital required for day-to-day working in a business concern, such as for purchasing raw material, for meeting day-to-day expenditure on salaries, wages, rents rates, advertising etc. But there are much disagreement among various financial authorities (Financiers, accountants, businessmen and economists) as to the exact meaning of the term working capital.

DEFINITION AND CLASSIFICATION OF WORKING CAPITAL:

Working capital refers to the circulating capital required to meet the day to day operations of a business firm. Working capital may be defined by various authors as follows:

1. According to Weston & Brigham - "Working capital refers to a firm's investment in short term assets, such as cash amounts receivables, inventories etc.
2. Working capital means current assets. —Mead, Baker and Malott
3. "The sum of the current assets is the working capital of the business" —J.S.Mill

Working capital is defined as "the excess of current assets over current liabilities and provisions". But as per accounting terminology, it is difference between the inflow and outflow of funds. In the Annual Survey of Industries (1961), working capital is defined to include "Stocks of materials, fuels, semi-finished goods including work-in-progress and finished goods and by-products; cash in hand and bank and the algebraic sum of sundry creditors as represented by

(a) outstanding factory payments e.g. rent, wages, interest and dividend;
(b) purchase of goods and services;
(c) short-term loans and advances and sundry debtors comprising amounts due to the factory on account of sale of goods and services and advances towards tax payments".

The term "working capital" is often referred to "circulating capital" which is frequently used to denote those assets which are changed with relative speed from one form to another i.e., starting from cash, changing to raw materials, converting into work-in-progress and finished products, sale of finished products and ending with realization of cash from debtors.

Working capital has been described as the "life blood of any business which is apt because it constitutes a cyclically flowing stream through the business".

CONCEPTS OF WORKING CAPITAL

There are two concepts of working capital viz. quantitative and qualitative. Some people also define the two concepts as gross concept and net concept. According to quantitative concept, the amount of working capital refers to 'total of current assets'. Current assets are considered to be gross working capital in this concept.

The qualitative concept gives an idea regarding source of financing capital. According to qualitative concept the amount of working capital refers to "excess of current assets over current liabilities."

L.J. Guthmann defined working capital as "the portion of a firm's current assets which are

financed from long–term funds."
The excess of current assets over current liabilities is termed as 'Net working capital'. In this concept "Net working capital" represents the amount of current assets which would remain if all current liabilities were paid. Both the concepts of working capital have their own points of importance. "If the objectives is to measure the size and extent to which current assets are being used, 'Gross concept' is useful; whereas in evaluating the liquidity position of an undertaking 'Net concept' becomes pertinent and preferable.

It is necessary to understand the meaning of current assets and current liabilities for learning the meaning of working capital, which is explained below.

Current assets – It is rightly observed that "Current assets have a short life span. These types of assets are engaged in current operation of a business and normally used for short– term operations of the firm during an accounting period i.e. within twelve months. The two important characteristics of such assets are,

(i) Short life span, and
(ii) Swift transformation into other form of assets.

Cash balance may be held idle for a week or two, account receivable may have a life span of 30 to 60 days, and inventories may be held for 30 to 100 days."

> Fitzgerald defined current assets as, "cash and other assets which are expected to be converted in to cash in the ordinary course of business within one year or within such longer period as constitutes the normal operating cycle of a business."

Current liabilities – The firm creates a Current Liability towards creditors (sellers) from whom it has purchased raw materials on credit. This liability is also known as accounts payable and shown in the balance sheet till the payment has been made to the creditors.
The claims or obligations which are normally expected to mature for payment within an accounting cycle are known as current liabilities. These can be defined as "those liabilities where liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current assets, or the creation of other current liabilities."

Circulating capital – working capital is also known as 'circulating capital or current capital.'

"The use of the term circulating capital instead of working capital indicates that its flow is circular in nature."

STRUCTURE OF WORKING CAPITAL

The different elements or components of current assets and current liabilities constitute the structure of working capital which can be illustrated in the shape of a chart as follows:

STRUCTURE OF CURRENT ASSETS AND CURRENT LIABILITIES

Current Liabilities	Current Assets
Bank Overdraft	Cash and Bank Balance
Creditors	Inventories: Raw-Materials Work-in-progress Finished Goods
Outstanding Expenses	Spare Parts
Bills Payable	Accounts Receivables
Short-term Loans	Bills Receivables
Proposed Dividends	Accrued Income
Provision for Taxation, etc	Prepaid Expenses Short-term Investments

CIRCULATION OF WORKING CAPITAL

At one given time both the current assets and current liabilities exist in the business. The current assets and current liabilities are flowing round in a business like an electric current.

However, "The working capital plays the same role in the business as the role of heart in humanbody. Working capital funds are generated and these funds are circulated in the business. As and when this circulation stops, the business becomes lifeless. It is because of this reason that he working capital is known as the circulating capital as it circulates in the business just like blood in the human body."

1. Gross Working Capital: It refers to the firm's investment in total current or circulating assets.
2. Net Working Capital:The term "Net Working Capital" has been defined in two different ways:
    i. It is the excess of current assets over current liabilities. This is, as a matter of fact, the most commonly accepted definition. Some people define it as only the difference between current assets and current liabilities. The former seems to be a better definition as compared to the latter.
    ii. It is that portion of a firm's current assets which is financed by long-term funds.

Permanent Working Capital: This refers to that minimum amount of investment in all current assets which is required at all times to carry out minimum level of business activities. In other words, it represents the current assets required on a continuing basis over the entire year. Tandon Committee has referred to this type of working capital as "Core current assets".

Working Capital may be classified in two ways (Kinds of Working Capital)

a) Concept based working capital
b) Time based working capital
c) Classification on the basis of financial reports.

CONCEPT BASED WORKING CAPITAL

1. Gross Working Capital
2. Net Working Capital
3. Negative Working Capital

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3. Negative Working Capital: This situation occurs when the current liabilities exceed the current assets. It is an indication of crisis to the firm.

TIME BASED WORKING CAPITAL

1. Permanent or Fixed Working Capital
    (a) Regular Working Capital
    (b) Reserve Working Capital
2. Temporary or Variable Working Capital

(a) Seasonal Working Capital
(b) Special Working Capital

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The following are the characteristics of this type of working capital:

1. Amount of permanent working capital remains in the business in one form or another. This is particularly important from the point of view of financing. The suppliers of such working capital should not expect its return during the life-time of the firm.

2. It also grows with the size of the business. In other words, greater the size of the business, greater is the amount of such working capital and vice versa Permanent working capital is permanently needed for the business and therefore it should be financed out of long-term funds.

2. Temporary Working Capital: The amount of such working capital keeps on fluctuating fromtime to time on the basis of business activities. In other words, it represents additional current assets required at different times during the operating year. For example, extra inventory has to be maintained to support sales during peak sales period. Similarly, receivable also increase and must be financed during period of high sales. On the other hand investment in inventories, receivables, etc., will decrease in periods of depression.

Suppliers of temporary working capital can expect its return during off season when it is not required by the firm. Hence, temporary working capital is generally financed from short- term sources of finance such as bank credit.

Classification on the basis of financial reports –The information of working capital can becollected from Balance Sheet or Profit and Loss Account; as such the working capital may be classified as follows:

(i) Cash Working Capital – This is calculated from the information contained in profit and

loss account. This concept of working capital has assumed a great significance in recent years as it shows the adequacy of cash flow in business. It is based on 'Operating Cycle Concept'.

(ii) Balance Sheet Working Capital – The data for Balance Sheet Working Capital is collected from the balance sheet. On this basis the Working Capital can also be divided in three more types, viz., gross Working Capital, net Working Capital and Working Capital deficit.

NEED FOR AND COMPONENTS OF WORKING CAPITAL

For smooth running an enterprise, adequate amount of working capital is very essential.
Efficiency in this area can help, to utilize fixed assets gainfully, to assure the firm's long- termsuccess and to achieve the overall goal of maximization of the shareholders, fund. Shortage or bad management of cash may result in loss of cash discount and loss of reputation due to non-payment of obligation on due dates. Insufficient inventories may be the main cause of production held up and it

may compel the enterprises to purchase raw materials at unfavorable rates.

Like-wise facility of credit sale is also very essential for sales promotions. It is rightly observed that "many a times business failure takes place due to lack of working capital." Adequate working capital provides a cushion for bad days, as a concern can pass its period of depression without much difficulty.

O' Donnel correctly explained the significance of adequate working capital and mentioned that "to avoid interruption in the production schedule and maintain sales, a concern requires funds to finance inventories and receivables."

The adequacy of cash and current assets together with their efficient handling virtually determines the survival or demise of a concern. An enterprise should maintain adequate working capital for its smooth functioning. Both, excessive working capital and inadequate working capital will impair the profitability and general health of a concern.

Therefore working capital is needed till a firm gets cash on sale of finished products. It depends on two factors:

i. Manufacturing cycle i.e. time required for converting the raw material into finished product; and

ii. Credit policy i.e. credit period given to Customers and credit period allowed by creditors.

Thus, the sum total of these times is called an "Operating cycle" and it consists of the following six

steps:

i. Conversion of cash into raw materials.
ii. Conversion of raw materials into work-in-process.
iii. Conversion of work-in-process into finished products.
iv. Time for sale of finished goods—cash sales and credit sales.
v. Time for realization from debtors and Bills receivables into cash.
vi. Credit period allowed by creditors for credit purchase of raw materials, inventory and creditors for wages and overheads.

DETERMINANTS OF WORKING CAPITAL :

The factors influencing the working capital decisions of a firm may be classified as two groups, such as internal factors and external factors. The internal factors includes, nature of business size of business, firm's product policy, credit policy, dividend policy, and access to money and capital markets, growth and expansion of business etc. The external factors include business fluctuations, changes in the technology, infrastructural facilities, import policy and the taxation policy etc. These factors are discussed in brief in the following lines.

I. Internal Factors

1. Nature and size of the business

The working capital requirements of a firm are basically influenced by the nature and size of the business. Size may be measured in terms of the scale of operations. A firm with larger scale of operations will need more working capital than a small firm. Similarly, the nature of the business - influence the working capital decisions. Trading and financial firms have less investment in fixed assets. But require a large sum of money to be invested in working capital. Retail stores, business units require larger amount of working capital, where as, public utilities need less working capital and more funds to invest in fixed assets.

2. Firm's production policy

The firm's production policy (manufacturing cycle) is an important factor to decide theworking capital requirement of a firm. The production cycle starts with the purchase and use of raw material and completes with the production of finished goods. On the other hand production policy is uniform production policy or seasonal production policy etc., also influences the working capital decisions. Larger the manufacturing cycle and uniform production policy – larger will be the requirement of working capital. The working capital requirement will be higher with varying production schedules in accordance with the changing demand.

3. Firm's credit policy

The credit policy of a firm influences credit policy of working capital. A firm following liberal credit policy to all customers requires funds. On the other hand, the firm adopting strict credit policy and grant credit facilities to few potential customers will require less amount of working capital.

4. Availability of credit

The working capital requirements of a firm are also affected by credit terms granted by its suppliers – i.e. 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 conditions, will be operated with less working capital than a firm without such a facility.

5. Growth and expansion of business

Working capital requirement of a business firm tend to increase in correspondence with growth in sales volume and fixed assets. A growing firm may need funds to invest in fixed assets in order to sustain its growing production and sales. This will, in turn, increase investment in current assets to support increased scale of operations. Thus, a growing firm needs additional funds continuously.

6. Profit margin and dividend policy

The magnitude of working capital in a firm is dependent upon its profit margin and dividend policy. A high net profit margin contributes towards the working capital pool. To the extent the net profit has been earned in cash, it becomes a source of working capital. This depends upon the dividend policy of the firm. Distribution of high proportion of profits in the form of cash dividends results in a drain on cash resources and thus reduces company's working capital to that extent. The working capital position of the firm is strengthened if the management follows conservative dividend policy and vice versa.

7. Operating efficiency of the firm

Operating efficiency means the optimum utilisation of a firm's resources at minimum cost.
If a firm successfully controls operating cost, it will be able to improve net profit margin which, will, in turn, release greater funds for working capital purposes.

8. Co-ordinating activities in firm

The working capital requirements of a firm are depend upon the co-ordination between production and distribution activities. The greater and effective the co-ordinations, the pressure on the working capital will be minimized. In the absence of co-ordination, demand for working capital is reduced.

II. External Factors

1. Business fluctuations

Most firms experience fluctuations in demand for their products and services. These business variations affect the working capital requirements. When there is an upward swing in the economy, sales will increase, correspondingly, the firm's investment in inventories and book debts will also increase. Under boom, additional investment in fixed assets may be made by some firms to increase their productive capacity. This act of the firm will require additional funds. On the other hand when, there is a decline in economy, sales will come down and consequently the conditions, the firm try to reduce their short-term borrowings. Similarly the seasonal fluctuations may also affect the requirement of working capital of a firm.

2. Changes in the technology

The technological changes and developments in the area of production can have immediate effects on the need for working capital. If the firm wish to install a new machine in the place of old system, the new system can utilise less expensive raw materials, the inventory needs may be reduced there by working capital needs.

3. Import policy

Import policy of the Government may also effect the levels of working capital of a firm since they have to arrange funds for importing goods at specified times.

4. Infrastructural facilities

The firms may require additional funds to maintain the levels of inventory and other current assets, when there is a good infrastructural facility in the company like transportation and communications.

5. Taxation policy

The tax policies of the Government will influence the working capital decisions. If the Government follows regressive taxation policy, i.e. imposing heavy tax burdens on business firms, they are left with very little profits for distribution and retention purpose. Consequently the firm has to borrow additional funds to meet their increased working capital needs. When there is a liberalized tax policy, the pressure on working capital requirement is minimized.

Thus the working capital requirements of a firm are influenced by the internal and external factors.

MEASUREMENT OF WORKING CAPITAL:

There are 3 methods for assessing the working capital requirement as explained below:

a) Percent of Sales Method

Based on the past experience, some percentage of sale may be taken for determining the quantum of working capital

b) Regression Analysis Method

The relationship between sales and working capital and its various components may be plotted on Scatter diagram and the average percentage of past 5 years may be ascertained. This average percentage of sales may be taken as working capital. Similar exercise may be carried out at the beginning of the year for assessing the working capital requirement. This method is suitable for simple as well as complex situations.

c) Operating Cycle Method

As a first step, we have to compute the operating cycle as follows:

i) Inventory period: Number of days consumption in stock = I ÷ M/36
Where I– Average inventory during the year

M = Materials consumed during the year

ii) Work-in-process: Number of days of work-in-process = W ÷ K/365 Where W = Average work-in-process during the year

K = Cost of work-in-process i.e., Material + Labour + Factory overheads.

iii) Finished products inventory period = G ÷ F/365

Where G = Average finished products inventory during the year F= Cost of finished goods sold during the year

iv) Average collection period of Debtors = D ÷ S/365

Where D = Average Debtors balances during the year S = Credit sales during the year

v) Credit period allowed by Suppliers = C ÷ P/365

Where C = Average creditors' balances during the year

P = credit purchases during the year vi) Minimum cash balance to be kept daily.

Formula: O.C. = M + W + F + D – C

Note : It is also known as working capital cycle. Operating cycle is the total time gap between the purchase of raw material and the receipt from Debtors.

The calculation of net working capital may also be shown as follows ; Working Capital = Current Assets – Current Liabilities

= (Raw Materials Stock + Work-in-progress Stock + Finished Goods Stock + Debtors + Cash Balance) – (Creditors +Outstanding Wages + Outstanding Overheads).

Where,

Raw Materials = Cost (Average) of Materials in Stock

Work-in-progress Stock = Cost of Materials + Wages +Overhead of Work-in-progress. Finished Goods Stock = Cost of Materials + Wages +Overhead of Finished Goods. Creditors for Material = Cost of Average Outstanding Creditors.

Creditors for Wages = Averages Wages Outstanding. Creditors for Overhead = Average Overheads

Outstanding. Thus,

Working Capital = Cost of Materials in Stores, in Work-in-progress, in Finished Goods and in Debtors.

Less : Creditors for Materials
Plus : Wages in Work-in-progress, in Finished Goods and in Debtors.

Less :Creditors for Wages

Plus : Overheads in Work-in-progress, in Finished Goods and in Debtors.

Less : Creditors for Overheads.

The work sheet for estimation of working capital requirements under the operating cycle method may be presented as follows:

ESTIMATION OF WORKING CAPITAL REQUIREMENTS

I Current Assets:	Amount	Amount	Amount
Minimum Cash Balance		****	
Inventories :			
Raw Materials	****		
Work-in-progress	****		
Finished Goods	****	****	
Receivables :			
Debtors	****		
Bills	****	****	
Gross Working Capital (CA)		****	****
II Current Liabilities :			
Creditors for Purchases		****	
Creditors for Wages		****	
Creditors for Overheads		****	****
Total Current Liabilities (CL)		****	****
Excess of CA over CL			****
+ Safety Margin			****
Net Working Capital			****

The following points are also worth noting while estimating the working capital requirement:

1. Depreciation: An important point worth noting while estimating the working capital requirementis the depreciation on fixed assets. The depreciation on the fixed assets, which are used in the production process or other activities, is not considered in working capital estimation. The depreciation is a non-cash expense and there is no funds locked up in depreciation as such and therefore, it is ignored. Depreciation is neither included in valuation of work-in-progress nor in finished goods. The working capital calculated by ignoring depreciation is known as cash basis working capital. In case, depreciation is included in working capital calculations, such estimate is known as total basis woking capital.

2. Safety Margin: Sometimes, a firm may also like to have a safety margin of working capital inorder to meet any contingency. The safety margin may be expressed as a % of total current assets or total current liabilities or net working capital. The safety margin, if required, is incorporated in the working capital estimates to find out the net working capital required for the firm. There is no hard and fast rule about the quantum of safety margin and depends upon the nature and characteristics of the firm as well as of its current assets and current liabilities

Example.1
Hi-tech Ltd. plans to sell 30,000 units next year. The expected cost of goods sold is as follows:

	Rs. (Per Unit)
Raw material	100
Manufacturing expenses	30
Selling, administration and financial expenses	20
Selling price	200

The duration at various stages of the operating cycle is expected to be as follows :

Raw material stage	2 months
Work-in-progress stage	1 month
Finished stage	1/2 month
Debtors stage	1 month

Assuming the monthly sales level of 2,500 units, estimate the gross working capital requirement. Desired cash balance is 5% of the gross working capital requirement, and working- progress in 25% complete with respect to manufacturing expenses.

Solution:

Statement of Working Capital Requirement

1. **Current Assets**:	Amt. (Rs.	Amt. (Rs.)
Stock of Raw Material (2,500×2×100)		5,00,000
Work-in-progress:		
Raw Materials (2,500×100)	2,50,000	
Manufacturing Expenses 25% of (2,500×30)	18,750	2,68,750

Finished Goods:			
Raw Materials (2,500×½×100)	1,25,000		
Manufacturing Expenses (2,500×½×30)	37,500	1,62,500	
Debtors (2,500×150)			3,75,000
			13,06,250
Cash Balance (13,06,250×5/95)			68,750
Working Capital Requirement			13,75,000

Note: Selling, administration and financial expenses have not been included in valuation of closing stock.

Example.2

Calculate the amount of working capital requirement for SRCC Lt d. from the following information:

	₹. (Per Uni t)
Raw materials	160
Direct labour	60
Overheads	120
Total cost	34 0
Profit	60
Selling price	400

Raw materials are held in stock on an average for one month. Materials are in process on an average for half-a-month. Finished goods are in stock on an average for one month. Credit allowed by suppliers is one month and credit allowed to debtors is two months. Time lag in payment of wages is 1½ weeks. Time lag in payment of overhead expenses is one month. One fourth of the sales are made on cash basis.

Cash in hand and at the b ank is expected to be Rs. 50,000; and expect ed level of production Cash in hand and at the bank is expected to be Rs. 50,000; and expected level of production amounts to 1,04,000 units for a year of 52 weeks.

You may assume that pro duction is carried on evenly throughout the year and a time period of four weeks is equivalent to a month.

Solution :

Statement of Working Capital Requirement

1. Current Assets :	Amt. (Rs.)	Amt. (Rs.)
Cash Balance		50,000
Stock of Raw Materials (2,000×160×4)		12,80,000

Work-in-progress :		
Raw Materials (2,000×160×2)	6,40,000	
Labour and Overheads (2,000×180×2)×50%	3,60,000	10,00,000
Finished Goods (2,000×340×4)		27,20,000
Debtors (2,000×75%×340×8)		40,80,000
Total Current Assets		91,30,000

2. Current Liabilities :

Creditors (2,000×Rs. 160×4)	12,80,000
Creditors for Wages (2,000×Rs. 60×1½)	1,80,000
Creditors for Overheads (2,000×Rs. 120×4)	9,60,000
Total Current Liabilities	24,20,000
Net Working Capital (CA–CL)	67,10,000

Example.3
JBC Ltd. sells goods on a gross profit of 25%. Depreciation is considered as a part of cost of production. The following are the annual figures given to you :

Sales (2 months credit)	Rs. 18,00,000
Materials consumed (1 months credit)	4,50,000
Wages paid (1 month lag in payment)	3,60,000
Cash manufacturing expenses (1 month lag in payment)	4,80,000
Administrative expenses (1 month lag in payment)	1,20,000
Sales promotion expenses (paid quarterly in advance)	60,000

The company keeps one month's stock each of raw materials and finished goods. It also keeps Rs.

1,00,000 in cash. You are required to estimate the working capital requirements of the company on cash cost basis, assuming 15% safety margin .

Solution:

Statement of Working Capital Requirement

1. Current Assets :	Amt. (Rs.)
Cash-in-hand	1,00,000
Debtors (cost of sales i.e. 14,70,000×2/12)	2,45,000
Prepaid Sales Promotion expenses	15,000
Inventories :	

Raw Materials (4,50,000/12)	37,500
Finished goods (12,90,000/12)	1,07,500
Total current assets	5,05,000

2. Current Liabilities :

Sundry creditors (4,50,000/12)	37,500
Outstanding Manufacturing exp. (4,80,000/12)	40,000
Outstanding Administrative exp. (1,20,000/12)	10,000
Outstanding Wages (3,60,000/12)	30,000
Total current liabilities	1,17,500
Excess of CA and CL	3,87,500
+ 15% for contingencies	58,125
Working capital required	4,45,625

Working Notes :

1. Cost Structure		Rs.
Sales		18,00,000
– Gross profit 25% on sales		4,50,000
Cost of production		13,50,000
– Cost of materials	Rs. 4,50,000	
– Wages	3,60,000	8,10,000
Manufacturing expenses (Total)		5,40,000
– Cash Manufacturing expenses		4,80,000
Therefore, Depreciation		60,000

2. Total cash cost :

Cost of production	13,50,000
– Depreciation	60,000
+ Administrative expenses	1,20,000
+ Sales promotion expenses	60,000
Total Cash Cost	14,70,000

IMPORTANCE OR ADVANTAGES OF ADEQUATE WORKING CAPITAL

Working capital is the life blood and nerve centre of a business. Just as circulation of blood is essential in the human body for maintaining life, working capital is very essential to maintain the smooth running of a business. No business can run successfully without an adequate amount of working capital. The main advantages of maintaining adequate amount of working capital are as follows:

1. Solvency of the business: Adequate working capital helps in maintaining solvency of the business by providing uninterrupted flow of production.

2. Goodwill: Sufficient working capital enables a business concern to make prompt payments and hence helps in creating and maintaining goodwill.
3. Easy loans: A concern having adequate working capital, high solvency and good credit standing can arrange loans from banks and other on easy and favourable terms.
4. Cash discounts: Adequate working capital also enables a concern to avail cash discounts on the purchases and hence it reduces costs.
5. Regular supply of raw materials: Sufficient working capital ensures regular supply of raw materials and continuous production.
6. Regular payment of salaries, wages and other day-to-day commitments: A company which has ample working capital can make regular payment of salaries, wages and other day-to-day commitments which raises the morale of its employees, increases their efficiency, reduces wastages and costs and enhances production and profits.
7. Exploitation of favourable market conditions: Only concerns with adequate working capital can exploit favourable market conditions such as purchasing its requirements in bulk when the prices are lower and by holding its inventories for higher prices.
8. Ability to face crisis: Adequate working capital enables a concern to face business crisis in emergencies such as depression because during such periods, generally, there is much pressure on working capital.
9. Quick and regular return on investments: Every Investor wants a quick and regular return on his investments. Sufficiency of working capital enables a concern to pay quick and regular dividends to its investors as there may not be much pressure to plough back profits. This gains the confidence of its investors and creates a favourable market to raise additional funds i.e., the future.
10. High morale: Adequacy of working capital creates an environment of security, confidence, and high morale and creates overall efficiency in a business.

DISADVANTAGES OF REDUNDANT OR EXCESSIVE WORKING CAPITAL

1. Excessive Working Capital means ideal funds which earn no profits for the business and hence the business cannot earn a proper rate of return on its investments.
2. When there is a redundant working capital, it may lead to unnecessary purchasing and accumulation of inventories causing more chances of theft, waste and losses.
3. Excessive working capital implies excessive debtors and defective credit policy which may cause higher incidence of bad debts.
4. It may result into overall inefficiency in the organization.
5. When there is excessive working capital, relations with banks and other financial institutions may not be maintained.
6. Due to low rate of return on investments, the value of shares may also fall.
7. The redundant working capital gives rise to speculative transactions.

DISADVANTAGES OR DANGERS OF INADEQUATE WORKING CAPITAL

1. A concern which has inadequate working capital cannot pay its short-term liabilities in time. Thus, it will lose its reputation and shall not be able to get good credit facilities.
2. It cannot buy its requirements in bulk and cannot avail of discounts, etc.
3. It becomes difficult for the firm to exploit favourable market conditions and undertake profitable projects due to lack of working capital.
4. The firm cannot pay day-to-day expenses of its operations and its creates inefficiencies, increases costs and reduces the profits of the business.
5. It becomes impossible to utilize efficiently the fixed assets due to non-availability of liquid funds.