

Method 1: Operating or WC cycle or cash cycle
 Method 2: Component wise estimate or Quantitative estimate method

Approaches of WCM \rightarrow WC Inv. policies			
Basis	Aggressive	Moderate	Conservative
WC	Low	Adequate	High
Risk	High	Medium	Low
Profitability	High	Trade-off	Low
Liquidity	Low liquidity	Trade-off	High liquidity
Inventory	Lower level of inv		higher level of inventory
Credit Policy	Strict	maintain	Liberal
Cash Bal	Less Low		High
Advantages	Refer ICM Book		
Disadvantages			

* OPERATING CYCLE / WC CYCLE / CASH CYCLE / CASH TO CASH CYCLE

Operating cycle $R + W + F + D - E = \text{Days}$

R = Raw material storage period

W = WIP Inventory * holding period

F = Finished storage period

D = Receivables / Debtors collection period

E = Credit period allowed by supplier

* WIP Inventory may also be termed as Work cost or Conversion cost

M	T	W	T	F	S	S
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

No. of OC in a yr = $\frac{360 \text{ or } 365}{OC} = \text{times}$ 2022

Amt. of WC Requirement = $\frac{\text{Annual Operating Cycle}^*}{\text{No. of operating cycle}}$
(refer Notes)

* Annual Operating Cycle or Annual Operating Expense or Total Operating Exp.
= COGS + Admin OH + S & D

* Various components of OC calculation :-

1) RM Storage period = $\frac{\text{Avg. St. of RM}}{\text{Avg. RM consumed per day}}$

where, Avg. Stock of RM = $\frac{\text{Op. RM} + \text{Cl. St. of RM}}{2}$

RM consumed = Op. St. of RM + purch - Cl. St. of RM.

2) WIP conversion period = $\frac{\text{Avg. St. of WIP}}{\text{Avg. prodn cost per day}}$

where, Avg. St. of WIP = $\frac{\text{Op. St. of WIP} + \text{Cl. St. of WIP}}{2}$

Productn cost = Op. St. of WIP + RM consumed + wages +
Pdn exp - Cl. St. of WIP.

3) FG Storage period = $\frac{\text{Avg. St. of FG}}{\text{Avg. cost of goods sold per day}}$

where, Avg. St. of FG = $\frac{\text{Op. St. of FG} + \text{Cl. St. of FG}}{2}$

COGS = Op. St. of FG + Prodⁿ cost - Cl. St. of FG.

S	M	T	W	T	F	S
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

MAY - 2022

4) Debtor / Receivable collection Period
= $\frac{\text{Avg. Receivable}}{\text{Avg. credit sales per day}}$ x 30

2022

$$\text{Avg. Receivables} = \frac{\text{Op. Receivable} + \text{Cl. Receivable}}{2}$$

WEDNESDAY
JUNE

22

WK 26 (173-192)

5) Credit period allowed to suppliers

$$= \frac{\text{Avg. Payable}}{\text{Avg credit purchase per day}}$$

$$\text{Avg Payables} = \frac{\text{Op. Payables} + \text{Cl. Payables}}{2}$$

NOTE:- OC \rightarrow Lower the better

Estimate WC 1) $\frac{\text{Annual op. cost}}{\text{No. of OC in one yr}} + \text{Desired cash.}$

Reductⁿ in WC (PVQ Jan '21)

M	T	W	T
4	5	6	7
11	12	13	14
18	19	20	21
25	26	27	28

Question 17

The following information is provided by MNP Ltd. for the year ending 31st March ,2020:

Raw Material Storage period	45 days
Work-in-Progress conversion period	20 days
Finished Goods storage period	25 days
Debt Collection period	30 days
Creditors payment period	60 days
Annual Operating Cost	Rs.25,00,000
(Including Depreciation of Rs.2,50,000)	
Assume 360 days in a year.	
You are required to calculate:	

- (i) Operating Cycle period
- (ii) Number of Operating Cycle in a year.
- (iii) Amount of working capital required for the company on a cost basis.
- (iv) The company is a market leader in its product and it has no competitor in the market. Based on a market survey it is planning to discontinue sales on credit and deliver products based on pre-payments in order to reduce its working capital requirement substantially. You are required to compute the reduction in working capital requirement in such a scenario. (PYP 5 Marks, Jan'21)

Question 8

A company is considering its working capital investment and financial policies for the next year. Estimated fixed assets and current liabilities for the next year are ₹ 2.60 crores and ₹ 2.34 crores respectively. Estimated Sales and EBIT depend on current assets investment, particularly inventories and book-debts. The Financial Controller of the company is examining the following alternative Working Capital Policies:

(₹ in crore)



Working Capital Policy	Investment in Current Assets	Estimated Sales	EBIT
Conservative	4.50	12.30	1.23
Moderate	3.90	11.50	1.15
Aggressive	2.60	10.00	1.00

After evaluating the working capital policy, the Financial Controller has advised the adoption of the moderate working capital policy. The company is now examining the use of long-term and short-term borrowings for financing its assets. The company will use ₹ 2.50 crores of the equity funds. The corporate tax rate is 35%. The company is considering the following debt alternatives.

Financing Policy	Short-term Debt	Long-term Debt
Conservative	0.54	1.12
Moderate	1.00	0.50
Aggressive	1.50	0.50
Interest rate-Average	12%	16%

295/507

You are required to CALCULATE the following:

(i) Working Capital Investment for each policy:

- (a) Net Working Capital position
- (b) Rate of Return
- (c) Current ratio

(ii) Financing for each policy:

- (a) Net Working Capital position.
- (b) Rate of Return on Shareholders' equity.
- (c) Current ratio. (RTP May '19, Nov'18)