

Working Capital

Management

Topics to be Covered

- Estimation of Working Capital Requirement
- Working Capital Requirement in case of New Company.
- Additional working Capital Requirement due to change in no. of shifts
- Financing of working capital

- The company will estimate the working Capital Requirement at the beginning of financial year.
- Any over estimation will result in excess loan leading to higher interest
- Any Underestimation will result in liquidity crunch

⇒ Gross Working Capital: Aggregate of All current assets

⇒ Net working capital: Current Assets
(-) Current Liabilities

In this chapter we will have holding periods of current assets

Some examples are:

- 1) Raw material holding period
- 2) Finished goods holding period

It also has lag periods for following current assets & current liabilities

- 1) Creditors
- 2) wages
- 3) Power, Rent
- 4) Selling & Distribution OH

It also has

- Debtor collection period

How to find Amounts by using holding/lag periods:

Formulas:

• Raw Material Stock

$$\frac{\text{Raw Material Consumed}}{365 / 52 / 12} \times \text{Raw Material holding period}$$

• Finished Goods Stock

$$\frac{\text{Factory / works cost}}{365 / 52 / 12} \times \text{Finished goods holding period}$$

• Debtor $\frac{\text{Credit Sale} \times \text{Debtor Period}}{365/52/12}$

• Cash & Bank will be given

• Prepaid expenses

$$\frac{\text{Total Expenses}}{365/52/12} \times \text{Period of Pre-payment}$$

• Work in Process Stock

$$\frac{\text{R.M. Consumed} \times \text{WIP Period} \times \text{DOC}}{365/52/12}$$

$$+ \frac{\text{Conversion Cost} \times \text{WIP Period} \times \text{DOC}}{365/52/12}$$

Conversion cost includes

- + Direct wages
- + Direct expenses
- + Factory OH

DOC means: Degree of Completion

- where No information is given about the DOC, then we take 100% at Raw Material consumed and 50% at conversion cost.

• Creditor

$$\frac{\text{Credit Purchase} \times \text{Creditor Period}}{365/52/12}$$

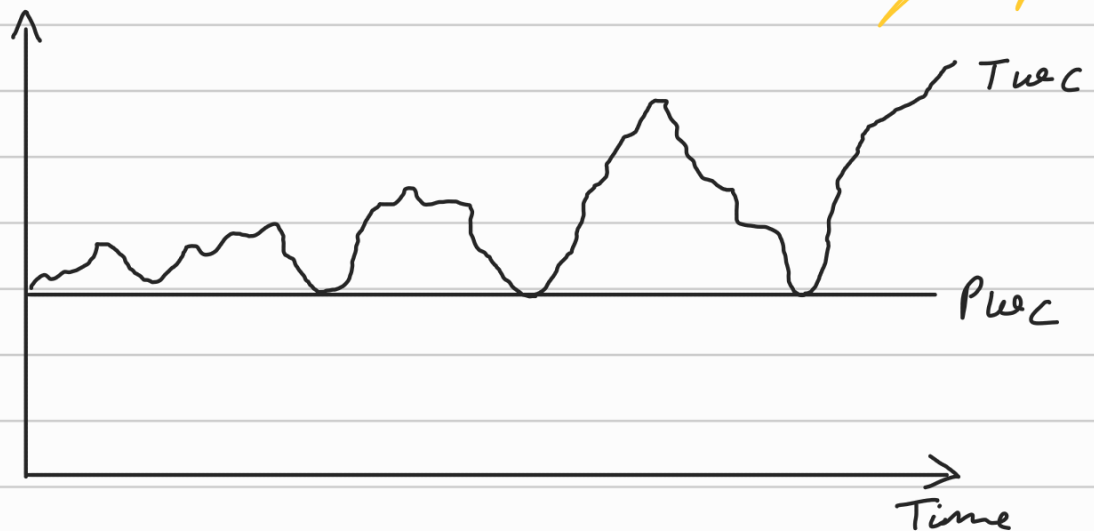
Cash Cost working Capital

- 1) Depreciation, should be excluded from factory overhead
- 2) Debtors should be valued at total cost instead of Sale.

working Capital Requirement in case of a New Company / New Project

In case of a New Company having first year of business, we will prepare detail cost sheet showing closing Stock (opening stock will be considered as Nil)

Permanent working Capital vs Temporary working Capital



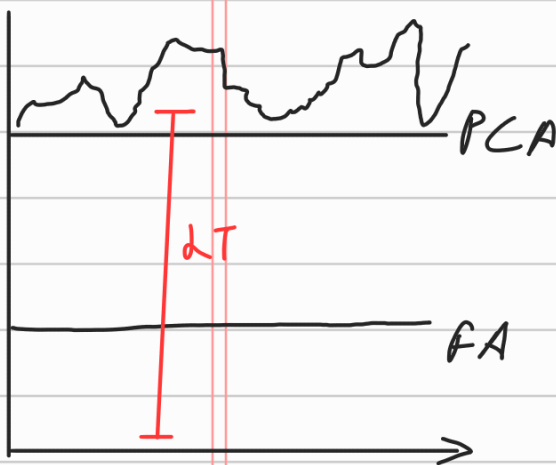
Permanent working Capital refers to the minimum working capital which will be maintained throughout the year. It is also known as fixed working capital or hard core working capital.

Temporary working capital refers to the working capital which is maintained only during peak season and not during off season.

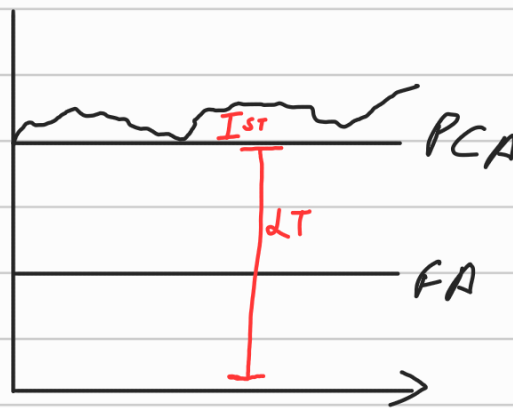
It is also known as fluctuating working capital or Soft core working capital.

Financing of working capital

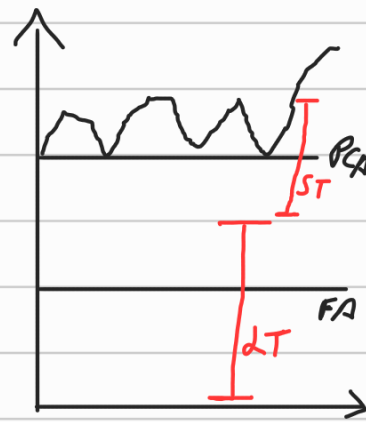
Conservative



Moderate



Aggressive



Liquidity	Max	Moderate	Minimum
Risk	Minimum	Moderate	Maximum
Return	Minimum	Moderate	Maximum

