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An Analytical Study Of Working Capital & Its Relevance Of Small & Medium Scale Enterprise With Special Reference To Shourya Infrastructures

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Abstract

As we know Working capital is life blood of any business so it s very essential to know its effective utilization by using various financial techniques that here attempted to use in this study.There is a connection between the sale of the company's service and Current assets that is positive.therefore, effective and productive control of the Current assets is crucial In Current Assets, and more than half of the total capital of the firm is generally invested. Management of Working Capital (WC) too, therefore attracts the attention of the management. W. C needs are more often finance through outside source so it is necessary to utilise them in the best possible way.

For small units, W. C management is most important because they scarcely rely on the long-term capital market and have easy access to short-term financial sources such as trade In the modern system approach to management the operations of the firm are viewed as the total that is an integrated system. Hence an overall look on the management of the WC is necessary.

Key Words- Working Capital, Current Assets, Current Liabilities

I.Introduction

Working Capital (WC) is defined as, the capital which is used in day to day operations of an organization. It is the capital which is needed to finance Current Assets (CA) of an organization. It is a measure of short term financial health and organizations operational efficiency. WC in much simpler way is the difference between organizations CA and its CL.

1.2. Components of WC

WC has two main components, they are CA and CL.

CA:

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CA is a asset which can reasonably be expected to be sold, consumed or exhausted through normal operation of a business within the current fiscal year or operating cycle. It constitute of the following.

Inventories: It represents component and underdone material ,finished goods and work in progress.

Trade debtors(TD): TD consist of credit sale to customer.

Prepaid Expenses: Prepaid expenses are the expenses that we have to pay for goods and provide service which benefits have to be received.

Loan &Advances: They represents loans and advances given by a firm to another firm for a short period of time.

Investment: These assets comprises of short-term surplus funds invested in government securities, shares and short term bonds.

Cash & bank balance: It represents cash in hand and at the bank that is used for meeting functioning requirements.

CL:

CL is that part of the obligations that the company generally has to clear to outside parties within a year in the short period. These commitments include the following.

Sundry creditor: This liabilities stem out of purchase of raw material on credit terms usually for period of one or two months.

Bank overdraft: Bank overdraft includes withdraws in too much of credit balance standing in firms current account with banks.

Short term loans: The short term loans show the short term borrowings by the firm from banks and others which is to be repay within a year comprise short term loan. Example cash credit.

Provisions: This includes provision for taxation, contingencies and proposed dividends.

WORKING CAPITAL CYCLE / OPERATING CYCLE

It implies that the time period that is required from the time cash is put in the business along with other inputs to the time, it is recovered from the amount of sales made by the firm.

The length of WC or operating cycle mostly depends upon length of the manufacturing process and holding period of inventories.

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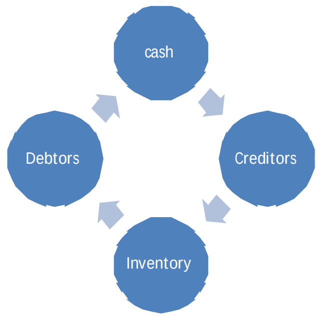

Diagram: WC cycle/operating cycle

SCOPE FOR WC MANAGEMENT

For small units, WC management is most important because they scarcely rely on the long-term capital market and have easy access to short-term financial sources such as trade credit, short-term bank loan, etc.

In the modern system approach to management the operations of the firm are viewed as the total that is an integrated system. Hence an overall look on the management of the WC is necessary.

TYPES OF WC

The various types of WC are discussed below:

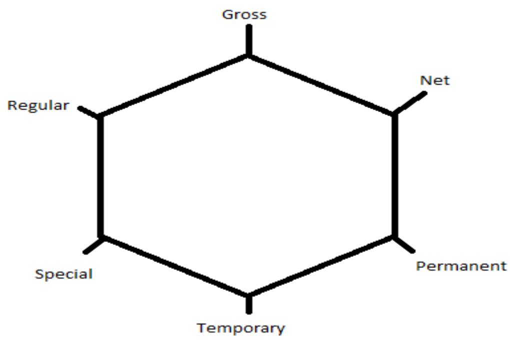

Diagram: Main Types of WC (WC)

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Gross Working Capital (GWC): It is the sum of all CA. It includes assets such as cash, accounts receivables, inventory, short term investment and marketable securities.
Net Working Capital (NWC): It is the too much of CA over CL.
It is a qualitative concept.
NWC = (CA - CL)
Permanent Working Capital (PWC): Permanent WC is the minimum sum of cash, inventory & debtors maintained to carry on business operations swimmingly at any time during a convincing period.
Temporary Working Capital (TWC): It is called as 'circulating WC'. It is influenced by seasonal fluctuations of business concerns.
Special Working Capital (SWC): It is the amount of WC to meet unforeseen eventualities that may arise during the course of operations.
Regular Working Capital (RWC): This is the amount of WC required for the continuous operation of an enterprise.

FACTORS AFFECTING WC

The WC needs of a firm are affected by various factors. The important factors are as follows
Quality of business

Production policies

Market conditions

Seasonal fluctuations

Growth and expansions activities

Operating efficiency

Credit policy

Sales growth

Dividend policy

OBJECTIVES OF THE STUDY

To study the concept of WC management

To study the scope of WC management

To know the component and types of WC management

To know the factors that affect WC

To understand the WC cycle/operating cycle

To analyze the process of financing of WC

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To study WC management in Shourya infrastructures, Aurangabad

1.7 RESEARCH METHODOLOGY

Research:

Research is defined as attentive deliberation of learning regarding a specific concern or a problem using scientific methods.

Research Methodology:

Research methodology is the specific procedure or technique used to identify select, process and analyse information about a topic. Research methodology adopted for analytical study is as follows

Quantitative methods of data collection like existing data is used for collections of data. Quantitative methods of data collections like interview of proprietor are also used to enrich the collections of data.

The audited financial statement that is balance sheet of the firm for the previous year 2018-19, 2017-18 and 2016-17 is used for analysis of WC management of the firm.

Statistical technique such as ratio analysis, percentage, charts, graphs and diagrams are used for data analysis and interpretation.

Data collections

The process of gathering and measuring information on Targeted variable in an established system is called as a data collection.

Data Sources

Primary data

A data that is collected by researcher from first hand sources using methods like surveys, interviews or experiments is known as Primary data. It is collected with the research project in mind directly from primary sources. In the given research the primary data collected through observation technique and Interview with proprietor.

Secondary data

A data that does not collected by the researcher personally but previously generated by somebody else and already processed is known as Secondary data. In the given research the secondary data collected through financial statement of firm, reference book and internet.

Financial statement of firm

The majority of the data collected through the balance sheet of the firm for previous three years which help to compare different financial ratio in terms of WC management.

The theoretical concepts drawn from different financial reference books.

Internet

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Research Problem	A Study of working capital management in Shourya infrastructures.
Type of research Design	Descriptive research design
Firm	Shourya Infrastructures
Place	Aurangabad
Period of Survey	20 May 2019 to 19 July 2019
Data collection Method	Primary and Secondary Data
Data Sources	Interview & observation technique
Analysis approach	Descriptive
Tools used for data analysis and interpretation	Ratio analysis, percentage, charts, Graphs and diagram

Financing of Working Capital

Sources of WC financing

The need of WC finance is fulfilled by various sources as discuss below,

Bank overdraft:

Bank overdraft is the most frequent source of bank financing, allowing a customer to withdr aw more than their credit balance in the account.

Cash credit: Cash credit is the most popular source of bank financing for WC. In cash credit a bank finance a particular limit upto which a borrower can borrow. A bank may demand security in the form of hypothecation of CA.

Bills discounting(BD): **A** bill of interchange

drawn on his debtor by a creditor is a flexible tool. BD contains an unconditional order to pa y the creditor a certain amount of money after a certain period of time. Bank charges the bo rrower for discounting bills to a specified commission.

Letter of credit: Letter of credit is an indirect way of financing WC in which banks liability arises only if the purchaser fails to make the payment. It is most popular source of WC finance in international trade.

Trade credit (TC):

The trade credit suggested the credit that the supplier allowed the company to purchase. It' s just the way for lenders to delay the fee.

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ASSESSMENT OF WC FINANCE

The two most important method followed by bank for assessing WC finance are namely traditional method (Tondon committee method) and Turnover method (Nayak Committee method).

Traditional method

This method is recommended by Tondon committee appointed by Reserve Bank of India to suggest some guidelines regarding the bank borrowing for WC purpose. So this method also called as Tondon committee method. In this method the amount of bank limit can be determined as under,

Method of Lending	1st method	2nd method2
Total current assets	2000	2000
Less other current liabilities	200	200
Working capital gap(1-2)	1800	1800
Minimum stipulated net working capital	450*	500**
Maximum permissible bank finance	1350	1300

* Under 1st method it is 25% of WC gap
**Under 2nd method, it is 25% of total CA.

According to 1st method the borrower can be allowed maximum bank finance upto 75% of the WC gap.

As per the 2nd method the contribution of the borrower has to be 25% of the total CA build up.

This method is also known as Tondon committee method.

Turnover method

This method of assessing WC is also known as Nayak committee method as it is suggested by Nayak committee constituted by Reserve Bank of India(RBI).

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Rs. In Lakhs

Estimated sales turnover(Projected sale)	80
Minimum working capital @25% of estimated sales(3months sales)	20
Contribution of borrower @5%	4
Minimum bank credit for working capital @20% of projected sales	16

As per this method ,
the WC is estimated to be at least 25% of the sales turnover financed through bank financin g at a minimum of 20% and the borrowers contribute 5% of the projected sales.This method applies to the WC limit upto Rs. 5 crores for manufacturing and upto Rs. 2 crores for other activities.
This method is also known as Nayak committee method
This is the most common and popular method for assessment of WC finance.

Calculation Of Drawing Power

Cash credit is sanction for WC requirements. Margin is the contribution of the borrowers in financing a security.

Drawing power is the extent of finance which a borrower can avail at any given point of time. In case of cash credit (WC limits) the drawing power is calculated as value of security less margin. Drawing power cannot be more than the sanction limit.

Example: X is having sanction limit of Rs.10 lakhs, value of stock is Rs.16 lakhs, margin is 25% calculate the drawing power? In this case margin is 4 lakhs.

Rs. in lakhs

Value of stock	16
Margin (25% of stock)	4
Drawing Power 75% of stock value	12

As per the calculation drawing power is Rs.12 lakhs. The sanction limit is Rs. 10 lakhs. As the drawing power cannot exceed limit, hence the drawing power is only Rs. 10 lakhs and not Rs. 12 lakhs in this case.

Important Financial Ratios Used In Assessment Of The Wc Finance

Current ratio(CR):

It reflects the relationship between the CA and CL.
Current ratio is equal to CA divided by CL.

$$\text{Current ratio} = \frac{\text{current asset}}{\text{current liabilities}}$$

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The ideal CR preferred by bank is 1.33:1.CR measures short term liquidity of the concern and its ability to meet its short term obligations within a time span of a year. It shows the liquidity position of the Enterprise.

Acid test or Quick ratio

It is the ratio between quick CA and CL. This should be at least one.

Acid Test or Quick ratio=$\frac{\text{quick current asset}}{\text{current liabilities}}$

Here, quick current asset is cash, bank balance, receivable upto 6 month + quick realisable securities such as government securities, quoted shares and bank fixed deposits.

Operating profit ratio

It is express as,

Operating Profit ratio=$\frac{\text{Operating Profit}}{\text{Net Sales}}$*100

Higher the ratio indicates operational efficiency.

Stock/ inventory turnover ratio

Stock inventory turnover ratio is equal to sales divided by average stocks

Here

Average stock =$\frac{\text{opening stock} + \text{closing stock}}{2}$

This ratio indicates the number of times the inventory is rotated during the accounting period.

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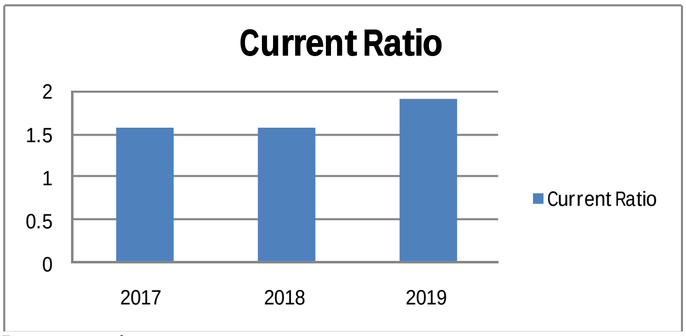
DATA ANALYSIS AND INTERPRETATION

Current Ratio $= \frac{Current\ Asset}{Current\ Liability}$

Year	current ratio
2017	1.58
2018	1.58
2019	1.90



Interpretation:

The CR of the firm for 2017, 2018 and 2019 is 1.58, 1.58 and 1.90 respectively. In 2017 and 2018 due to less variations in CA and CL the CR is almost same. In 2019, due to increase in work order lead towards significant change in CA and CL which result in increase in current ratio upto 1.90. The current ratio trends of the firm reflect sound financial positions of firm as a significant liquidity is available .The current ratio is higher than the standard benchmark of RBI that is 1.50 which is a good sign for firm to borrow adequate WC from bank and financial institutions.

Quick Ratio/Acid Test

Quick ratio / acid test $= \frac{\text{Quick current assets}}{\text{current liabilities}}$

Here quick CA include cash, bank balance, receivable upto 6 months and quick realisable securities like fixed deposit, government securities and quoted shares.

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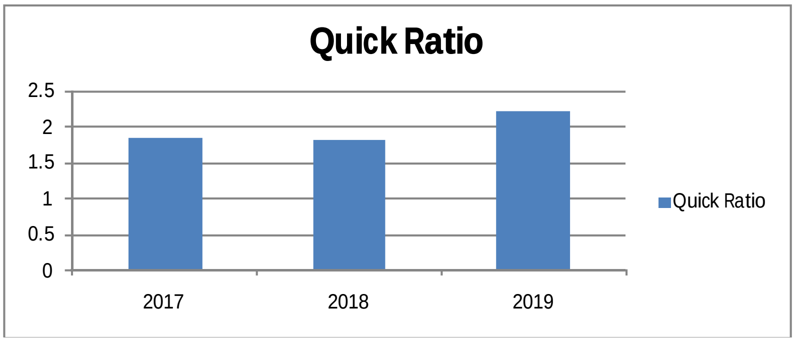
Year	Quick Ratio
2017	1.84
2018	1.83
2019	2.21



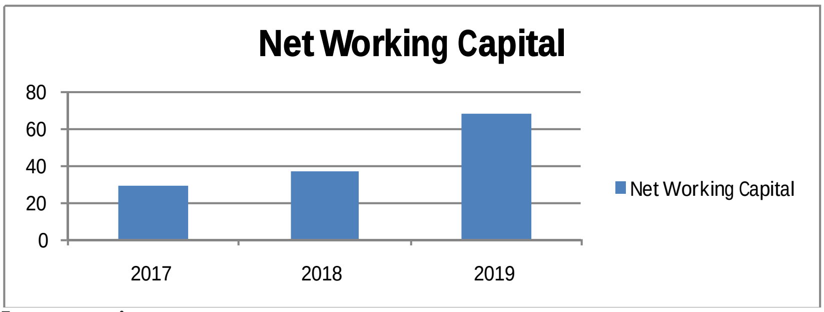
Interpretation:

The quick ratio of the firm for 2017, 2018 and 2019 is 1.84 ,1.83 and 2.21.This ratio satisfied the liquidity positions of the firm which shows good financial health of the firm.

Net WC

Net WC=CA-CL

Year	Net Working capital(Rs. in lakhs)
2017	30
2018	37
2019	68



Interpretation:

The Increasing trend of availability of net WC shows adequate capital is available for the firm to invest in new project as well as fulfil the requirement of capital for current or running projects. It also highlight the growth of firm in positive direction.

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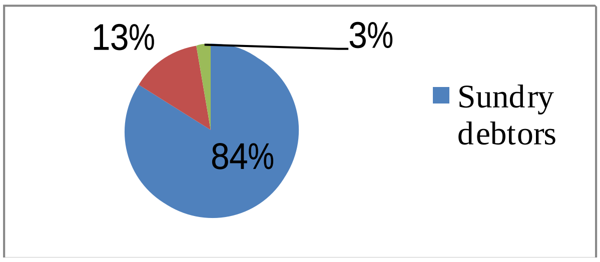
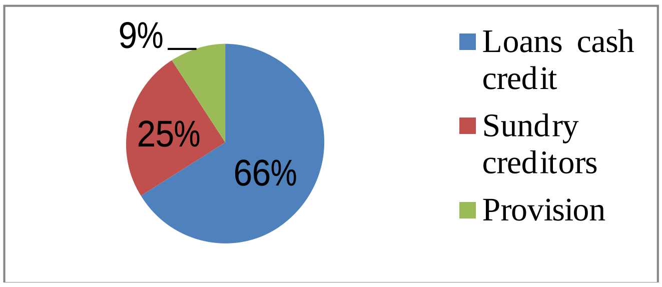
Sources of current asset



Interpretation:

The major portion of CA of the firm are coming from sundry debtors which is around 84%.It reflects the firm have good number of working orders. At the same time it has cautious sign that the firm should get these receivables within a permissible time of 90 days to avoid liquidity crunch. Cash and bank balance constituted 13% share in CA. It used for daily expenses. Loan and advances given to others for short term period constitute 3% of capital assets of firm.

Sources of CL



Interpretation:

Short term loan like cash credit constitute major portion of CL of firm which is 66% of total CL. Sundry creditors cover 25% portion of CL. It means around 1/4th of CL of the firm should repay within a cycle of 90 days. Provision constitutes 9% of total CL.

LEARNING OUTCOME

I have understood the basic concept of WC and its components like CA and CL.

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I studied the different types of WC.

I have learned the scope of WC Management.

I have analysed the different features which affect the WC Management.

I learned the process of Financing of WC and its assessment through different methods.

I have understood the concept of WC cycle.

FINDINGS

Sundry debtors occupied the major portion of CA which is around 84%.

The major portion of CL is cover by loans that is cash credit which is around 66% of total CL.

The net WC of the firm shows increasing trend.

The current ratio of the firm is good which around 1.90 for financial year 2018-19 is.

SUGGESTIONS

The trend of current ratio shows continuous increase from previous years. It shows the firm have sufficient liquidity to meet unforeseen situations. It is good sign for firm.

The sundry debtors covered 84% of total current asset. It shows firm have good work orders, at the same time the firm should take care that it recovered on time mostly within standard period of 90 days to avoid liquidity issue.

The sundry creditors have 25% share in total CL. It shows the firms repayment history to their vendors is prompt and within time. It positively affect the reputation of firm in the market.

Presently the firm confined their work only to Optical fibre cable lay down. The firm need to explore new opportunities and diversify its work orders to manage business risk.

The firm's client base is restricted and very few so the need of hour is to increase client base so more revenue will be generated for the firm which further help in expansion of business.

The major expenses of firm go for payment of hiring machineries like JCB and pockland. If firm purchase the machinery it will definitely help to save money and increase overall profitability of the firm.

LIMITATIONS

Time constraints: A descriptive study of the WC management is not possible to finish in merely a period of 2 months.

Resource constraints: Resources available for study is limited.

Data collection: The study is mostly depend on past facts and information from previous financial statement of firm.

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The in depth study of WC management of firm is not possible for the single person in confined time frame

CONCLUSION

In this project its studied WC Management for Shourya Infrastructures. The project include the study of WC Management its components, types and sources.
The project also highlighted the assessment of WC on the basis of different methods.
This is studied that the factors which affect the WC Management. also understand the scope of WC Management & analysed the importance of WC for a firm like Shourya Infrastructures which basically work in service sector. The project study in overall provides me an insight about the WC Management for smooth functioning and Business expansion of the firm.