



# Module-C Unit-9

## JAIIB PAPER-3

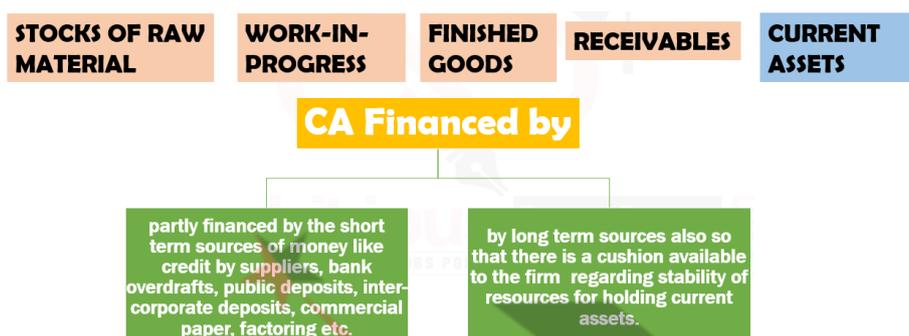
### **Accounting & Financial Management for Bankers(AFM)**



## JAIB Paper 3 (AFM) Module C Unit 9 - Working Capital Management

### Introduction

- The role of a financial manager does not stop with arranging long term sources of finance for creation of fixed assets to enable the firm to carry out its intended business operations.
- The money is also required for purchasing raw materials, converting them into finished goods and selling on credit to customers.



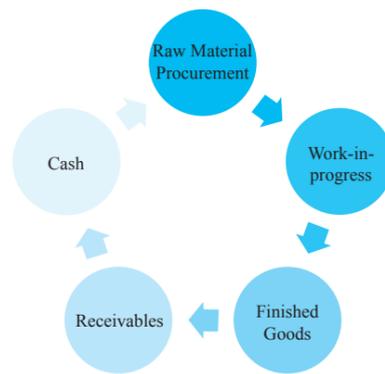
- A portion of these assets is to be financed Financial management of working capital involves management of both current assets and the sources to finance them.

### Working Capital Cycle

The normal operations of a business enterprise consist of some or all of the actions like, purchase of raw materials, processing/conversion of raw materials into finished goods, selling these goods on cash/ credit basis, receive cash on sale or end of credit period and again purchase raw materials. This is called working capital cycle. ***The length of this cycle depends on:***

- The stocks of raw materials required to be held.
- The work in process, which in turn depends on the process involved in manufacturing/processing to convert the raw materials into finished goods.
- The credit required to be provided to the purchasers.

The longer the working capital cycle, the more is working capital requirement, i.e., the need for maintaining the current assets.



### **Current Assets Of A Firm**

**Current assets depends on various factors. The main factors that influence the need of working capital in a business are as under:**

#### **Nature of Business:**

- Public utility undertakings such as electricity, water supply and railways require very little working capital finance because they sell their services on cash terms. They supply services not products, and very little funds are tied up in inventories and receivables.
- On the other hand, trading and financial firms require less investment in fixed assets but need large sums as working capital and fixed investments.

#### **Size of the business:**

- Greater the size of the business, greater is the requirement of working capital.

#### **Production Policy:**

- If the policy is to keep production steady-not geared to peak and non-peak nature of business-then there will be an accumulation of inventories in the off peak season.
- An average production level will help take care of this issue by ensuring the surplus of production in off peak season is disposed of during the peak season.

#### **Seasonal variations:**

- Generally, during the busy season, a unit will require larger working capital than in slack season.

#### **Operating/Working capital cycle:**

- It is the duration of the operating cycle that determines the requirements of working capital.
- Longer the cycle larger is the requirement of working capital.
- The cycle duration decides the carry of inventory, the amount of labour and costs, and other expenses.
- **For example**, if the firm has to import raw material, it may have to maintain a bigger stock, to take care of supply disruptions.

- Similarly, if industry practice is to provide 3 months' credit to customers, it will also have to do so.

***In general, the current assets required to be held by a firm, can be classified as under:***

- Cash & cash equivalents
- Inventory
- Receivables
- Other current assets

### **Sources Of Finance For Current Assets**

**The following are the main sources of finance for acquiring current assets;**

- Firm's own working capital funds
- Accruals
- Trade Credit
- Working Capital Advance by Commercial Banks/ Financial Institutions
- Public Deposits
- Inter-Corporate Deposits
- Rights Debentures for Working Capital
- Commercial Paper
- Factoring
- Forfaiting

### **Working Capital Assessment By Banks**

- First step in any method of assessment of working capital limits: Deciding on the Level of Turnover of the firm
- In case of existing enterprises, the past performance is used as a guide to make an assessment and In case of new enterprises, this is based on the production capacity, proposed market share, availability of raw materials, industry norm, etc.
- Despite analysis of all the data, accurate estimate of future turnover is often an area of disagreement between the bank and the borrower.
- Based on the projected turnover, banks adopt various methods for assessing the working capital needs of a firm

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