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CHAPTER - III

CONCEPTUAL FRAME WORK

INTRODUCTION :

In this chapter conceptial aspects relating to working capital management have been discussed in brief. Here different views inrespects of working capital given by different authorities in the subject have been given and for this purpose the concept of working capital is explained with simple examples and diagrams. In order to have complete idea about employment of working capital in the business organisations different components have been explained alongwith principibles of working capital management practices.

3.1 MEANING AND DEFINATION :

MEANING :

Working capital which is a part of the total capital circulates from one to another in the ordinary conduct of business working capital is the amount of funds which company must have to finance its day to day operation. This idea indicates recurring transactions from the cash to inventories to receivables to cash that forms the conventional chain of business operation.

Generally, there are two working capital concept net and gross. Net working capital is difference between current assets and current liabilities. It is also known as excess of current assets over current liabilities. i.e. current asset minus current liabilities. Current assets are those assets which can converted into cash within accounting year and included cash, marketable securities, debtors, bills receivable and stock current liabilities which are to be paid within accounting year. It includes trade creditors, bills payable, Bank overdraft and outstanding expenses.

Gross working capital is nothing but the amount of funds invested in current assets. This is a going concern concept.

Networking capital concept is qualitative in nature and gross working capital concept is quantitative in nature.

FOCUS OF NET AND GROSS CONCEPTS OF WORKING CAPITAL :

Net concept
- Relationship between C.A. and C.L.
- Perspective short term and long term
- Evaluation by external parties
- Optimum balance among Risk, Return and Liquidity

WORKING CAPITAL

Gross Concept
- Individual current assets
- Perspective short term
- Evaluation by management
- Optimum investment in indivudual C.A.
- Financing of Current Assets.
- Utilisation of short term or surplus funds.

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The above mentioned concepts gross and net are not exclusive.corporate liquidity includes both the aspects. Qualitative when it measures the technical solvency and quantitative, when it considers the quantum of current assets and its utilisation from the management point of view, both the concept have equal significance.

DEFINATIONS :

a) working capital define in the following way :

a) ACCORDING TO MEAD, BAKER AND MALOTT :

"working capital means current assets "

b) ACCORDING TO HOAGLAND :

"Working capital is descriptive of that capital which is not fixed. But the more common use of the working capital is to consider it as difference between the book value of the current liabilities.

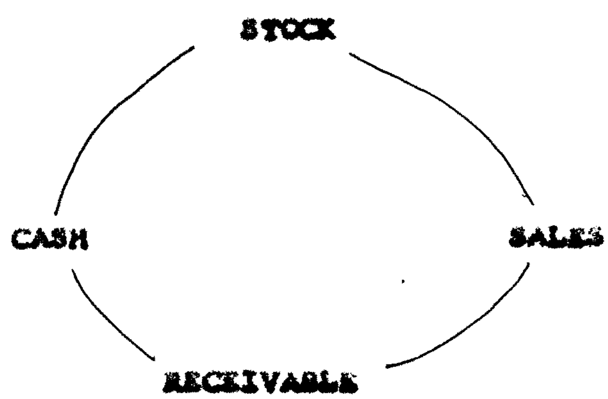
C) ACCORDING TO SHUBIN :

"working capital is the amount of funds necessary to cover the cost of operating the enterprise. working capital in a going concern is revolving fund. It consist of cash receipt from sales which are used to cover the cost of the current operation"

d) ACCORDING TO GERESTENBERG :

"Circulating capital means current assets of the company that are changed in the ordinary course of the business from one into another. As from example : from cash into inventories into receivables into cash.

Thus the working capital represents the operation funds, i.e. also known as circulating fund.



CIRCULATING WORKING CAPITAL

Gerestenberg explains, the working capital is working of business undertaking essentially entails a process of conversion of cash into goods into cash with intermediate stages i.e. stocks, sales, receivables and realisation of cash.

CLASSIFICATION OF WORKING CAPITAL :

The amount of funds required for meeting current needs varies from time to time in every business. Working capital is classified into two way.

i) On the basis of concept.

ii) On the basis of time.

On the basis of concept, working capital is classified as gross working capital and net working capital.

On the basis of time, working capital is classified as under. :

A) Permanent/fixed working capital.

B) Temporary/variable working capital.

WORKING CAPITAL

Permanent/Fixed working capital		Temporary/variable working capital	
Regular	Reserve	Seasonal	Special

a) FIXED OR PERMANENT WORKING CAPITAL :

This capital keeps the concern running. This capital is permanently locked up, in the circulation of current assets such as minimum stock of raw materials, work in progress, finished and semi fixed goods, loose tools equipment. This capital is again classified as :

i) REGULAR WORKING CAPITAL :

It is required for maintaining minimum amount of liquid capital needed to keep up the circulation or capital from cash to inventories to receivables.

ii) RESERVE MARGIN : OR CUSHION WORKING CAPITAL :

Working capital is the excess amount over the needs for regular working capital to be provided for contingencies like rising prices, business depressions strike, special operations like research and experiment.

B) TEMPORARY/VARIABLE WORKING CAPITAL :

Variable working capital changes with volume of business or with output.

It may be sub divided into seasonal and special working capital.

i) Special working capital is needed for financing scheme as expansion, modernisation, experiments, researches.

ii) Seasonal working capital is required to meet seasonal needs arising out from booming condition in market.

3.2 NEED AND IMPORTANCE OF WORKING CAPITAL :

The need for working capital can not be over emphasised. Every business needs some amount of working capital. The need generally arises due to the time gap between production and realisation of cash from sales. There is an operating cycle involved in the sales and relisation of cash. There are time gaps in purchase of raw materials and production, production and sales and realisation of cash. An adequate working capital is essential for smooth and efficient operation of business. Therefore, the working capital is needed for the following purpose.

1. For the purchase of raw materials, components and spare.
2. To make prompt payment of wages and salaries.
3. To meet day to day expenses and over head cost. i.e. fuel, power, and office expenses.

4. To maintain inventories of raw matedals, work in progress, store and spare parts and finished stock.

5 To provide credit facilities to the customers.

6 To maintain the solvency of the concern.

7 To meet selling costs i.e. packing, Advertising.

8 An adequate working capital ensures require payment of demand to the share holders.

IMPORTANCE OF WORKING CAPITAL :

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

1. SECURITY AND CONFIDENCE :

The regular payments (routine) to works and other will create security and confidence in the minds of workers. A real sense of security resulting from a sufficient amount of working capital on hand will create confidence and loyalty only through the business it self but also among its customers, creditors and business associates.

2. INCREASES THE SOLVENCY :

The regular payments to vendors of raw materials will increase the solvency of business concerns. A manufacturing concern is bound collapse in the absence of ready cash available to pay the bills for materials, direct labour, advertising and distribution expenses.

3. CREATION OF SOUND GOOD WILL :

The prompt of bills to suppliers, wages to workers will not insure a continued supply of materials, but will establish credit for the future or for seasonal operation.

4. CONCESSIONS :

Due to the prompt payment, vendors will allow number of concessions like discounts, or venders may bear delivery expenses.

5 STEADY WORK AND EFFICIENCY OF WORKERS :

The adequacy of the working capital maintains the constant inflow of materials from which the steady work to workers may be maintained.workers will increase their efficiency.

6. EASY AVAILABILITY OF BANK LOANS :

Bank advance on the liquidity of the enterprises. The adequacy ofworking capital is an indication of soundness of the enterprise. Banks advance easily to such business concerns.

7. [illegible] EASILY :

[illegible]nce the [illegible]usines[illegible] concerns [illegible] their [illegible] good will even at the financial [illegible], the business [illegible] may be overcom[illegible]e.

8. [illegible] :

[illegible] sufficient amount of capital may be able to purchase the [illegible] which may available at meager price at [illegible] only. [illegible] stock [illegible] may be [illegible] of the working capital.

9. [illegible] :

[illegible] more amount of [illegible] capital will insure [illegible] amount of returns to investors and [illegible] their [illegible] rate of return.

10. [illegible] :

[illegible] " [illegible] like success " and nothing [illegible] success as quality and ability [illegible] promptly and without [illegible] reasonable [illegible] for cash payments, however it is not [illegible] that is important; the [illegible] security the sense of [illegible] the self confidence which psychologists [illegible] is an element of success."

3.3 FACTORS DETERMING [illegible] :

The size of the working capital tends mainly [illegible] upon the volume of activity, i.e. sales and production on the one hand and type of business carried on i.e. firm doing purchases; sales of consumer goods etc.

Besides the size and nature of business, following factors also influence the total investment in working capital of a business firm.

1. [illegible] :

The nature of business has an important bearing on its working capital needs. A public utility business like irrigation departments; will therefore require a large amount of fixed assets therefore a small amount of working capital is required. On the other hand business like merchandise or manufacturing organisations will require large amount of working capital and little amount of fixed assets. An industry which using important raw materials and stores it or an agriculture commodities, require huge amount of working capital because their seasonal [illegible].

2. [illegible] :

Movements of the business cycle bring about the shifts in working capital position, when the boom is on the companies [illegible] to substantial borrowing willing to paying higher rate of interest, economic decline will feature reserve trend where the companies are eaged to repay their short-borrowing-term. borrowing.

3. <u>PROMOTIONAL AND FORMATIVE PHASE</u> :

To start up of new project and initial years constitute the most important phase for planning and provisions of working capital funds. In practice, however thi fact is generally over looked and as a result, many new ventures run into financial difficulties in their early operating years. The capital expenditure phase for a new project which includes identification of this specification and source of individuals equipment and facilities to be acquired and intsalied, funds requirement etc. receive close and continuing attention, such type of attention is however not given to the investment in current assets through it constitues a major part of total investment.

4. <u>PRODUCTION POLICIES</u> :

Production policies have to be formulated on the basis the individual settling of each enterprise, and company which experience strong seasonal investment have special working capital problems. Such companies may try to maintain a steady rate of production thoughout year as against seasonal demands for their goods.

5. MANUFACTURING CYCLE :

An extended, time span between the raw material purchase and the completion of the manufacturing process yielding the finished product, will obviously mean a larger tie-up of funds in the form of enhanced working capital needs. Having selected the process of manufacture, care has to be exercised inadhering to the normal manufacturing cycle time. Certain policy steps concerning terms of credit for raw materials and other supplies procedure can help reduce working capital requirements.

6. GROWTH AND EXPANSION PROGRAMMES :

A business grows, additional working capital has to be found There is no specific formula to establish the link between growth in sales and working capital. Or current asset.The critical fact however is that the need of increased capital funds does not follow the growth in business activity but come before it. Advance planning of working capital is thus continuing necessity for a going concern.

Expansion of activities will involve additional investment in fixed assets to support increase production and sales.

7. VAGARIES IN SUPPLY OF RAW MATERIALS :

Certain raw materials loose problems in the matter of pocurement and holding. Their sources may be raw and irregular.

They may, therefore be less as enable to discipline of planned.

Inventory management, the enterprise may feel compelled to purchase and carry large reserves of these items to sustain smooth flow of production. In ventory levels rise, as a consequence using up more funds.

Some raw materials may be avaliable only in certain seasons so that these have to be obtained and stored in advance. In such circumstances the working capital requirement will be high.

8) COMPETITIVE CONDITIONS :

A company which enjoys a dominate hold on its market had little obliged to strain beyond a measure in satisfying customers requirements. This involves extra costs and creat necessary to manufacture variety of products and expand credit term in keeping with competition practices, more over, this requires more investment to be made in inventories and book-debts.

9) CREDIT AND COLLECTION POLICIES OF THE FIRM :

The credit terms granted to customers influence the working capital level. Liberal credit policy in respect of duration of credit and amount involved can prove to be expensive and also create funds problems. Stock collection procedure in the matter of collection of outstanding can also lock up funds.

10. <u>SHIFTS IN DEMAND FOR PRODUCTS</u> :

Some manufactured products are subject to seasonal fluctuations in sales. There are obvious difficulties in trying to match production speed to the ebb and flow of the seasonal demand pattern.

In the interest of full utilisation of resources steady production will have to be maintained independent of shifts in demand for the finished products.

This will result in progressive accumulation of finished goods inventories during the off season and their sudden disposal during the peak season. The rising stock level during the period of production in excess of demand will require increasing working capital to be provided.

11. <u>PRICE LEVEL CHANGES</u> :

The shifts in price levels over the years always create problem for the finance manager rapidly rising price create the need for more fund for maintaining the pleasant volume of activity for some levels on working capital position will very from company to company depending upon the nature of its operations as standing in the market.

12. <u>OPERATING EFFICIENCY</u> :

There is an obvious relationship between the operating efficiency of a company and its working capital position.

waste elimination improved co-ordination to cut delays, higher efficiency in operations and fuller utilisation of resources are among the assignment promptly explored to salvage the profits from erosion. There measures have also the effects of getting more out of a given volumes of working capital. Efficiency of operations accelerates the pace of cash cycle and improves the working capital turnover, releases the pressure on working capital by improving profitability.

13. PROFIT LEVELS AND PROFIT APPROPRIATION POLICY :

By the very nature of things, some enterprise generate high gross margin compared to others. High gross margin improve prospects of a higher ratio of internal generation of the completi of each cash cycle.

Net profit can be regarded as ultimate pointer of funds generation from within the enterprise.

But in practice, the net cash inflow operations, represented by a net profit plus depreciation can be considered as avilable cas at the end of the period, freedom from financial shocks is the setting in which the company can pursue its profitable operations, concentrating on teachnology, product quality customers service and other factors.

In profit appropriation policies, there involves dividend policies, taxation policies, reserve policies and depreciation policy. They are following in briefly.

a) DIVIDEND POLICY :

Dividend once declared, is a short term liability, leading to cash outgo. there are statutory requsations governing prompt disbursements of dividends due any payable.Industrial practices reveal valied reaction to the m interrelationship between working capital and dividend payment. Some consider the shortage of working capital as a strong reason to cut cash dividend. On the other hand there are instances, where dividend payment is continued, provided cash position is strong through earnings are not adequate enough to justify the payment.

b) TAXATION POLICY :

Tax liability is an in escapable element in working capital planning. It is a short term liability payable in cash. Tax is the first appropriation out of profits and the amount of tax is determined by prevailing tax regulations and is not left to the discreation and convenience of the enterprise management. The finance manager who is well informed in tax matter has appreciable scope for tax planning with a view to reducing the cash drain by way of tax.

c) DEPRECIATION POLICY :

Depreciation policy centres around the determination of the amount to be provided as depreciation charges to make up the ultimate resources for replacement of absolete assets. Enhanced rates of depreciation have the effect of a reducing profits correspondingly which in turn aids on holding back distribution of dividends. Depreciation policy exerts influence on the status of working capital in the enterprise from time to time.

d) RESERVE POLICY :

One of the important goal of enterprise management is to build up adequate reserve out of profit. Besides cash or funds position the urge to retain or plough back prifits often acts a major constraint on the dividend policy. Inconcern function well, the built up reserves constitute the strong base on which corporate growth and expansion has been sustained.

3.4 PRINCIPLES OF WORKING CAPITAL MANAGEMENT :

The working capital is essential to maintain the solvency and liquidity of the business. In the words of Prof. James C.Van Horne " Liquidity management involves deciding upon the amount and composition of assets and liabilities. These decision involve trade off between risk and profitability. The greater the relative proportion of liquid assets the less the risk of running out of cash. Other things being equal. However, profitability will also be less. The longer the composite maturity schedule of securities used to finance the firm the less risk of cash insolvency all other things being equal.

The consideration of liquidity and profitability are opposite. Liquidity is the ability to realise value in money. The concept of liquidity has two dimensions.

1. The time necessary to convert an asset into money and
2. The degree of certainty associated with the conversion or price realised of the assets.

Higher liquidity has a number of favourable implications like solvency of the business, continuity of production, easy availability of cash discounts, easy availability of banks loans, facility of season purchasing, steady return to share holders and easy overcoming of slumps etc.

While another aspect of working capital in regard to profitability cannot be neglected. The maintenance like speculative purchasing leading to locking up funds under utilisation of funds, accumulation of excess or surplus etc.

Prof. Guthman and Dougall pointed out as follows : Profitability must be related to solvency in order to achieve an adequate interpretation of working capital position and solvency.

The Balance sheet presents a static picture to which a dynamic element of projected earnings must be added. The importance of profits to expansions is frequently suggested in announced postpone ments of capital spending when earnings decline. The business that earns a high return on its owners investment has a large adventage to the extent that it is willing to retain such profit in its ability to retire debt, to build working capital and grow. The cash budget, then if it provides controls that improve profitability also contributes through such added earnings to solvency so also close careful planning and testing of these factors that produce changes in general working capital position.

3.5 SOURCES OF WORKING CAPITAL :

A large scale manufacturing concerns, may procure funds from various sources to meet its working capital needs. The sources of working capital are grouped into two classes. :

A) Longterm sources and,

B) Short term sources.

A) LONG TERM SOURCES :

'The long term working capital requirements includes the initial and regula r working capital. The investiment in the regular working capital is of permanent nature and require long term funds. The source of long term working capital are given as under :

i) ISSUE OF SHARES :

It is most important source of long term working capital.

As far as possible efforts be made to procure the maximum amount of regular working capital out of the proceeds of issue of shares. There is no obligation on the part of management to return the amount after a fixed period, secondly, no charge is created on assets of the company. The additional funds can be easily obtained when required for the expansion of the company. Thirdly, the company is under no obligation to pay a fixed rate of shares The permanent financing of working capital through the issue of shares put a certain limitations on the part of the corporation to trade an equity.

ii)

ISSUE OF DEBENTURE :

Regular working capital can be procured by issue of debenture or bonds. This method is adopted for satisfying the permanent working capital requirements and not seasonal needs. The main advantage in issue of debenture holders, the remaining amount can be utilised for the equity holders. Thus the rate of dividend for the ordinary shareholders can be sufficiently increased. But redumption of regular instalments of debentures remain a constant head ache for the management.

iii)

RESERVE AND SURPLUS

It is the cheapest and most convenient method of securing capital by an enterprise. This method is directed on one hand, to increased the quantum of profits, through the provision of additional deprecation allowance, development on undistributed profits and on the other, prevent an excessive distribution of profit by dividend, limitation progressive taxation of dividend or by compulsory deposit of company reserve.

iv) TERM LOANS :

Mid-term and long-term loans for a period above 3 years provide important sources of working capital, such term loans can be borrowed from the financial institutions i.e. I.D.B.I. I.F.C.I.

B) SHORT TERM SOURCES :

Short term requirement of working capital involve financing day to day business operation. Normally the duration of short term working capital requirement doesnot exceeds a year. Short term working capital requirement can be met from the external and internal sources.

1. INTERNAL SOURCES :

Following are the main sources of internal sources :

i) DEPRECIATION FUND :

Depreciation fund created out of profits of the company provide good source of working capital. They are not invested in an assetor distributed as dividends.

ii) PROVISION FOR TAXATIONS :

Tax is the appropriation out of profits and the amount of tax is determined by prevailing tax regulations. There remains a time lag between making the provision for and payment of taxation. A company may utilise such provision during the intermittent period temporarily.

iii) ACCURED EXPENSES :

The company sometimes post pone the payment of certain expenditure due on the data of finalisation of the accounts. These accured expenses (due but not paid) also constitute an important sources.

2. EXTERNAL SOURCES :

External sources means the sources providing finance for company's working capital other than of internal sources.

a) i.e. Bank Credit/cash credit: Bank credit and cash credit are the two primary sources of financing working capital in India, Bank loans and trade credit together finance about 75%. of working capital credit requirement of industry.

The Banker after scrunting of the loan application of the lines suggested by the Reserve Bank of India determines, the maximum lines of credit permissiable for period based on the margin requirements of the security offered. After getting the overall credit limit sanctioned by the banker, the company actually draws the funds needed from time to time.

b) PUBLIC DEPOSITS :

In Bombay and Ahmedabad, most of the cotton textile mills procure their working capital from these sources. It should be remembered that it is not very dependable source of finance because there is always the risk of withdrawal during the rainy day.

c) LOANS FROM MANAGING AGENTS :

It was a very popular source at procuring long and medium term finance from managing agents at negligible rate of interest or no rate of interest.

d) GOVT. ASSISTANCES :

Central and state Government provide short term finance to industries by allowing them tax concessions sanctioning direct loans or grant to industries.

e) OTHER FINANCE CORPORATION :

Funds can be obtained from special finance corporation e.g. I.F.C. S.I.C.I. I.D.B. I.C.I.C.I. But this source should not be touched for satisfying the variable working capital requirements.

3.6 ASSESSMENT OF WORKING CAPITAL MANAGEMENT :

The overall position of working capital is analysed by outside parties as well as by the management of the firm. The outside parties include trade creditors, banks and financial institutions, debenture holders and existing potential shareholders. The objectives of analysis of working capital position are to evaluate solvency, liquidity and cost of financing. The major tools for analysing working capital position are :

A) Ratios.

B) Fund flow statement.

A) RATIO ANALYSIS :

Ratio analysis is the process of determining and interpreting numerical relationships based on financial statement. A ratio is statistical yard stick that provides a measure of relationship between two variable or figures which have cause and relationship. Some commonly used ratios are briefly described :

1) CURRENT RATIO :

i) MEANING :

Current ratio is the ratio between current assets and current liabilities of the business. It is also known as "Working capital Ratio and 2:1 Ratio.

ii) FORMULA :

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

iii) COMPONENTS :

Current Ratio expresses the relation between current assets and current liabilities.current assets include cash in hand and bank, stock in trade, sundry debtors, marketable securities and prepaid expenses and current liabilities consists of sundry creditors, short term loans, and advances (including cash credit facilities taken from commercial banks, current maturities of long term debts). Current liabilities and provisions for taxes and other accured expenses.

iv) SIGNIFICANCE :

This ratio is very commonly used for finding out the credit strength of a concern. It also shows the amount of conversion of current assets meeting current liabilities.

2) QUICK RATIO :

Quick ratio is also called as "Liquid Ratio and Acid test Ratio. This ratio shows the ability of a business to meet its immediate committments. It is found out by dividing quick assets i.e. which are most convertiable in cash by current liabilities.

ii) FORMULA :

$$\frac{\text{Quick Assets}}{\text{Quick Liabilities}}$$

iii) COMPONENTS :

Quick ratio is concerned with liquid assets and liquid liabilities. Quick assets include, cash, debtors after providing for doubtful debts, marketable securities. Inventories are not included in current assets for the purpose of calculating this ratio.

Liquid or Quick Liabilities include creditors, Bills payable, Bank overdraft is not considered.

iv) SIGNIFICANCE :

Acid test ratio is more rigorous test of liquidity than current ratio. It gives better picture of the firms ability to meet its short term debts out of short term assets. rule of thumb is 1 : 1 for the quick ratio. If a business has quick ratio of at least 100 per cent, It is considered to be in a fastly good current financial position.

3. INVENTORY TURN OVER RATIO :

i) MEANING :

Inventory Turnover ratio, also known as stock turnover ratio in the traditional imagage. It establish as relationship between the cost of goods sold during a given period and the average amount of inventory outstanding during that period.

Inventory turnover ratio helps in determining the liquidity of a firm. It gives the rate at which inventories are converted into sales and them into cash. It assist the financial manager in evaluating inventory policy. Find out reasonableness of such policy at given level to avoid any danager of over stocking.

ii) FORMULA :

$$\text{INVENTORY TURNOVER RATIO} = \frac{\text{Cost of goods sold}}{\text{Average inventory}}$$

$$\text{AVERAGE INVENTORY} = \frac{\text{Opening inventory} + \text{Closing inventory}}{2}$$

iii) COMPONENTS :

Inventory turnover ratio is expressed through the relationship between cost of goods sold and average inventory at cost. For greatest accuracy in the calculation of inventory turnover ratio, monthly inventories should ordinarily be used. The analyst should always be conscious of the fact that is only rough approximation.

iv) SIGNIFICANCE :

Inventory turnover ratio is an indication of the velocity with which mercandise moves through the business. This ratio indicate reasonable level of finished stock to be held by a business. This ratio must also be considered with the ratio of stock to working capital.

A low inventory turnover may reflect dull business. High inventory turnover ratio indicates greater sale with the same inventory.

4. WORKING CAPITAL TURNOVER RATIO :

i) MEANING :

Working capital turnover ratio is determined by dividing cost of sales by net working capital. This ratio measures the rate of working capital utilisation. It also shows how many times the working capital turns over in trading transctions.

ii) FORMULA :

$$\text{Turnover of Working Capital Ratio} := \frac{\text{Cost of Sales}}{\text{Net working Capital}}$$

iii) COMPONENTS :

Working capital turnover ratio express the relationship between cost of sales and net working capital. Net working capital means current assets minus current liabilities. Current assets include cash, marketable securities, inventory, sundry debtors and prepaid expenses. And current liabilities consists of sundry creditors, short term loans and advances and provisions for taxes and accured expenses.

iv) SIGNIFICANCE :

A company showing a turnover in excess of industry standards may be in need of additional net working capital to be supplied by owners through reinvested earnings or sale of additional shares.

A company concern with a lower than average ratio may have an excess of investment in net working capital.

An decreasing ratio indicates that working capital less economically. In short, The higher the turnover, the greater the efficiency and larger the rate of profit

5) DAILY CASH FLOW :

i) MEANING :

Daily cash flow is found out dividing net profit depreciation by No.of days in a year.

ii) FORMULA :

$$\frac{\text{Net profit + Depreciation}}{\text{No.of working days in a year}}$$

iii) SIGNIFICANCE :

This is a crude ratio but useful for analysing the working capital position. It indicates the daily cash flow generation. It also indicates the time period which will be taken in repaying the debts with the help of normal working of the firm.

6) CASH RATIO :

i) MEANING :

Cash ratio is the relationship of current assets and cash balance(including bank balance). It may determined by dividing the total current assets to total cash.

ii) FORMULA :

$$\frac{\text{Cash including Bank balance}}{\text{Total current assets}}$$

iii) SIGNIFICANCE :

This ratio shows availability of cash meet the day to day requirement in relation to total current assets. Past experience may show the trend of relationship of cash with current assets. In short; if the ratio is higher than average it shows funds are lying idle contribution to the business.

B) FUND FLOW STATEMENT :

Fund flow statement nothing but receipt and payment statement. It also known as cash in and cash out statement. The flow of funds in a firm may be conceived as a continuous process for every use of funds, there must be an off setting source. In general, the assets of a firm respresent the net use of funds, its liabilities and net worth represents net sources. Thus the various sources and uses of funds are :

	SOURCE(inflows)		Applications (Out flows)
1.	Trading profits or funds provided by operations	1.	Trading loss or funds depleted by operation.
2	Issue of equity and preference shares(including premium or excluding discount)	2	Redumption of redemable preference shares(including premium or excluding discount)
3	Issue of Debentures (including premium or excluding discount)	3	Redumption of Debentures (including premium or excluding discount)
4	Long term loan	4	Repayment of long term.
5	Sale of Fixed assets	5	Purchase of fixed assets.
6	Sale of investments	6	Purchase of investments.
7	Non trading incomes i.e. dividend	7	Payment of dividend and non trading items if any.
8	Decrease in working capital	8	Increase in working capital.
	TOTAL		TOTAL

B) STATEMENT SHOWING CHANGES IN WORKING CAPITAL

Sr.No.	Particulars	Years		Effect on working capital	
		Previous Year	Current Year	Increase	Decrease
	CURRENT ASSETS				
1.	Cash in hand & Bank	-	-	-	-
2	Stock in Trade	-	-	-	-
3	Bills Receivable	-	-	-	-
4	Sundry Debtors	-	-	-	-
5	Marketable securities	-	-	-	-
6	Pre paid expenses	-	-	-	-
A	GROSS WORKING CAPITAL				
	CURRENT LIABILITIES				
1	Bills payable	-	-	-	-
2	Sundry Creditors	-	-	-	-
3	Short term Loans	-	-	-	-
4	Outstanding Liabilities	-	-	-	-
5	Income Tax Payable	-	-	-	-
6	Dividend declare	-	-	-	-
B	TOTAL LIABILITIES	-	-	-	-
A - B	Increase/Decrease in working capital	-	-	-	-

Above table shows the trend in the changes in working capital. An increase in the amount of any current assets in the current year in composition to that in the previous year results into an increase in the work ing capital. Similarly, decrease in the amount of any current assets in current year in composition to that in the previous year results into a decrease in working capital. On the other hand, An increase in any current liabilities in current year in comparision on the previous year results a decreases in working capital and vice versa. The to al increase and the total decrease is compared in the end, and the difference shows the decrease or increase in the working capital. An increase in working capital is the application of funds and decrease in working is the sources of funds.