
CHAPTER III

REVIEW OF PAST LITERATURE

CONFIDENTIAL LIBRARY
FOR MAPS

CHAPTER - III

REVIEW OF THE PAST LITERATURE

3.1. Mr. D.D.Chopra¹ in his article, 'Management of working capital' emphasises the importance of working capital management in the business world of raising costs and scarce funds. He evaluates the relevance of inventory receivables, loans and advances and cash and Banking.

Inventory, being the main user of funds, demands an effective control through minimum level, maximum level, Re-order level, Economic order quantity and A B C Analysis. A B C Analysis reduces inventory level by controlling purchases with a sense of priority, based on utility. The Inventory target is set after careful analysis of needs. Utmost effort is made to reach the target with the help of a task force drawn from the personnel of various departments.

The receivables must be kept low and the recovery of old receivables should be taken on a project basis. Suitable discounts may be offered to reduce fresh receivables.

A constant watch by financial group on availability and proper utilisation of loans, advances and deposits will help the firm in negotiating better terms with Bank.

3.2. Dr.K.C.Goyal and Prof. K.N.Nagar in their article 'Financing of working capital'² highlighted regarding long term financing short term financing and spontaneous financing of working capital and discussed the three approaches in financing the working capital viz. Hedging

approach, conservative approach and the trade off approach.

The hedging approach implies the financing of longterm fixed needs with longterm funds and short terms seasonal needs with short term needs. It has the risk of inadequacy of shortterm funds of meet the fluctuating seasonal needs.

The conservative approach envisages financing of all funds requirements with longterm funds and conservating shortterm funds for emergency, virtually making them out of use. The risk is low and so is the profitability.

The trade off approach is a via-media between the two approaches discussed above in respect of risk and profitability. The discretion of the decision makers in a particular situation decides the trade off between risk and profitability.

3.3. Dr. J. Agarwal and Mr. R.N. Rajpal³ in their article, 'Working Capital Management'. A survey and synthesis, make some important observations on working capital management.

Holding more cash during inflation enhances liquidity, but lowers profitability cash has transaction motive, precautionary motive, speculative motive and compensation motive. Therefore, cash necessitates judicious management.

Marketable securities form a good substitute for cash, but are influenced by default risk, interest rate risk and liquidity or marketability risk.

The maintenance of accounts receivable has its cost implications in an inflationary economy. Investment in this is affected by credit policy. If the expenses for follow up action and bad debt losses are low, investment in accounts receivable is profitable.

Optimum level inventory is the wisest choice and it avoids blocking of capital on one side and loss of customers 'goodwill' on the other. Optimum inventory keeps carrying cost, storage cost and ordering cost at a moderate level.

The major sources of short term financing include trade credit, bank loans and commercial papers. As the duration of maturity is inversely proportional to risk in payment as well as profitability is to be considered.

James. C. Vanhorne propagates that the trade off between profitability and risk can be determined once the opportunity cost of a change in liquid asset and maturity of the debt is known.

The dual financial goals of profitability and liquidity should be considered to ascertain the inter-relationship between current assets and current liabilities.

3.4. Though the working capital position is often taken as an index of state of health of a concern. Messrs S.B. Pandit and C.M. Nargolkar through their article "Relationship between profitability growth and working capital"⁴ try to bring out the realities of working capital position and its indications, and emphasise the need to look into the factors other than liquidity too, in order to appreciate the health of a concern the profitability and growth depend mainly on as to how efficiently

the current assets are managed over investment in current assets and over drawing of current liabilities are equally bad. While - managing the cash and the receivables turnover of inventory should be taken into account. Any increase in volume of operation necessitated by increase in sales should be supported only by external longterm funds.

3.5. Mr.M.N.Mishra in his article 'Problems of working capital managment during inflation'⁵ enlists the following points that may help financial managers tackle the situation. He describes three concepts of working capital gross working capital, net working capital and refined net concept.

Three factors i.e., the requirement of working capital the composition of current assets and liabilities and the ways of financing current assets, bear special significance during inflation.

The rise in price in inputs and other costs, increase in scale of operation and the practice of historical cost accounting necessitate introduction of additional working capital. Historical cost accounting reports swoollen profits and causes heavy burden of payment of dividend and taxes.

Composition of assets and liabilities gets upset during inflation due to the irregualr - inventory supply and increase in prepaid expenses, including prepayment of taxes. Investment in accounts receivable increases. Liabilities which do not carry interest burden are preferred.

There are various internal and external sources of financing current assets. While resorting to external financing the factors such as trade off between risk and profitability preference of investors and purchasing power gains (losses) associated with different sources etc., should be viewed clearly.

During inflation, to control the upward trend of working capital requirement, the finance manager should envisage accounting for changes, controlling, cost and new investments and managing inventories. The finance manager, again should improve turnover, credit, collection, creditors and cash for improving the availability of working capital.

3:6. The authors, Mr. K.Viyyanna Rao and Dr. G.Prasad in their article titled 'CHORE Committee and financing of working capital',⁶ highlight the recommendations of the CHORE Committee.

These recommendations include:-

1. Borrowers should contribute atleast 25% of the current assets from own funds and term finance.
2. Continuation of the existing types of lending viz., cash credit, loans and bills.
3. The resources of the bank should be more - widely spread.
4. Surplus funds generated during a firms working should not be used for expansion. It should be used to bring about a permanent reduction in its existing borrowing requirements of working capital.
5. Achievement of better inventory control.

No industry is in a position to contribute 25% of the current assets through internally generated funds external borrowings like shares, debentures and public deposits. The internal generation of funds is handicapped due to historical cost accounting, price controls, high corporate taxation and over growing inflationary trend. High interest rates, the functioning of M.R.T.P. Act and FERA, under utilisation of capacity, infrastructural bottlenecks and administrative delays together worsen the already aggravated situation. The scope for funds from external sources is not satisfactory due to slackness in capital market, unattractive yield on shares, institutionalisation of savings in the form of P.F, L.I.C. etc.,

The industry may be advised to change the traditional ways of working capital management, economise the use of funds, reduce the business costs, control the rising cost of production, use the convertible debentures and submit quarterly - projections of cash credit limits.

In the light of high interest rates, limited availability of credits and virulent inflation, modern methods must be employed for managing cash resources efficiently. To reduce the funds constraints, firms should bring down the excessive investment in inventories and receivables.

R E F E R E N C E S

1. Chopra D.D. : Management of working capital, The Chartered Accountant (Monthly Journal). August 1977, Vol. XXVI.No.II P.52-57.
2. Dr. Goyal K.C. : Financing of working capital, The & Management Accountant, 1984 September, Prof.Nagar K.N. Vol XIX. No.9, P.551-552.
3. Dr.Agarwal J. : Working Capital Management - As survey & and Synthesis, Chartered Secretary, Mr. Rajpal R.N. Dec. 1981. Vol. XI. No.12. P.1106-1111.
4. Mr. Pandit S.B. : Relationship between profitability growth & and working capital, The Chartered Accountant, March 1984, Vol. XXXII No. 5. P.567-571. Mr.Nargolkar J.M.
5. Mishra N. : Problems of Working Capital Management during inflation, Chartered Secretary, August 1980 Vol. X, No. 8. P.747-750.
6. Mr.Rao K.V. : CHORE Committee and Financing of working & Capital, Chartered Secretary, Oct. 1981. Dr. Praised G. Vol. XI. No.10. P.928-931.