

## WORKING CAPITAL

- Working capital refers to **funds required for carrying out day- to-day operations.**
- It is in fact the "life-blood" & "controlling-nerve of the unit.
- It includes **financing for all types of stocks and other recurring expenses.**
  - Purchase of raw materials, stores and spares
  - Payment of wages to employees
  - Payment of other expenses like operating expenses
  - Other expenses incurred in connection with the production, selling and administration



How much working capital will be required by a particular industrial undertaking will depend upon the production/ **operating cycle** i.e., from the time raw material is purchased to the time goods are sold and cash is realized.

### GROSS WORKING CAPITAL

Total fund requirement of the firm for day to day business operations which includes borrowers margin plus bank finance.

### NET WORKING CAPITAL

It means the excess of current assets over current liabilities or that portion of the firm's current assets financed by the long term funds (owned funds/ retained profits)

Even though banks are given freedom by RBI to fix the inventory norms etc, most Banks are still following the earlier methods prescribed by various committee appointed by RBI from time to time

## **TANDON COMMITTEE (1975) RECOMMENDATIONS**

It defines Working Capital Gap as the shortfall between total current assets and other current liabilities, it recommended three methods for computing Maximum Permissible Bank Finance (MPBF), of which only first two were accepted by RBI.

### **METHODS OF LENDING – ILLUSTRATION**

<b>LIABILITIES</b>		<b>ASSETS</b>	
Sundry creditors	100	Raw Material	200
Other current liabilities	50	Finished Goods	110
Short term bank credit	200	Sundry debtors	60
<b>Total</b>	<b>350</b>	<b>Total</b>	<b>370</b>

#### **1<sup>ST</sup> METHOD**

#### **2<sup>ND</sup> METHOD**

Total current (TCA)	370	Total current (TCA)	370
Other current liabilities (OCL) - Liabilities other than bank borrowings	150	Other current liabilities (OCL) → Liabilities other than bank borrowings	150
Working capital Gap (TCA-OCL)	220	Working capital Gap (TCA-OCL)	220
Less:25% of WCG	55	Less:25% of TCA	92
Maximum permissible bank finance	165	Maximum permissible bank finance	128
Excess Borrowings	35	Excess Borrowings	72
Current Ratio	1.17:1	Current Ratio	1.33:1

## **NAYAK COMMITTEE RECOMMENDATIONS (1993)**

Also known as **Annual Projected Turnover method** Eligibility Small Enterprises having aggregate sanctioned working capital fund based (WCF) limits up to Rs 5 Crore and Non SSI up to Rs. 2 crore

### **METHOD OF COMPUTATION:**

- Working Capital Requirement : 25% of annual projected turnover
- Sanction of Working Capital Limit : 20% of the projected turnover
- Margin (Borrower contribution: 5% of their annual turnover

## **KANNAN COMMITTEE RECOMMENDATION (1997)**

It recommended **CASH BUDGET SYSTEM** in which maximum gap between total revenue receipts and total payments is covered by bank finance, which is fixed as sanctioned working capital credit limit and disbursements are allowed based on monthly statement Cash Budget System is very suitable for seasonal industries like agro based industries, heater cooler wool etc.

**Q1: Company have Cash 50000, stock 30000, prepaid expenses Rs 5000, bank Rs 5000, debtors Rs 10000, creditors Rs 20000, outstanding expenses Rs 30000, bills payable Rs 10000. Calculate Gross working capital and Net working capital.**

**Q2: Capital invested in the current assets of the company known as \_\_\_\_\_.**

- a) Net working capital
- b) Gross working capital
- c) Current assets capital
- d) All of the above

**Q3: Net Working capital is the \_\_\_\_\_.**

- a) Capital borrowed from the Banks.
- b) Difference between Current Assets and Current Liabilities.**
- c) Difference between Current Assets and Fixed Assets.
- d) Cash and Bank Balance.

**Q4: Current assets does not include \_\_\_\_\_.**

- a) Cash and Cash Equivalents
- b) Account Receivables
- c) Pre-paid Expenses
- d) Furniture**

**Q5: \_\_\_\_\_ is an obligation that is payable within one year.**

- a) Current Assets
- b) Current Liability**
- c) Non-current Liability
- d) None of the above