Working Capital Management-4

Components of Working Capital Management

- Cash Management
- Inventory Management
- Receivables Management

Management of Cash

- As Cash is a very important Component of Working Capital
- Shortage of Cash will hamper the operations of a Business and excess of it will become unproductive.
- Cash includes Currency, Cheques, Bank Drafts, Marketable Securities and Time Deposits.
- Without Cash it is impossible to meet the working capital needs including payment of various Creditors.

Motives for Holding Cash

- **Transaction Motives**
- Transaction includes the act of paying or receiving cash in the normal course of Business.
- Payments include Payments for raw materials,wages, rent, interest,taxes etc.
- Receipts include sales revenue, interest on deposits and rents and dividend receipt etc.
- Since the receipts and payments donot match hence a firm holds cash to meet urgency and contingencies

- **Precautionary Motive**
- Sometimes Cash is needed to to act as a safety margin
- In case of emergencies excess amount of Cash is very useful
- Emergencies include increse in the price of the raw material,strikes,lock outs etc.
- **Speculative Motive**
- Speculative motive refers to holding cash to take advantage of a profitable opportunities.
- For example if the price of a raw material decreases the firm holding excess cash have the opportunity of taking the advantage of a situation.

- **Compensation Motive**
- For example if a bank requires that a minimum balance has to be maintained then that fund has to be committed.

Factors determining Cash Needs

- 1. Credit Position of the Firm
- 2. Status of Firm's Receivable
- 3. Status of Firm's Inventory Account
- 4. Nature of Business Enterprise
- 5. Management's Attitude towards Risk
- 6. Cash Inflows and Cash Outflows
- 7. Cost of Cash Balance

Details of Cash Cycle

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Materials Ordered	Materials Received	Payments	Cheque Clearance	Goods Sold	Customers gives Cheque	Cheque Recieved	Cheque Deposited	Funds Collected
A	B	C	D	E	F	G	H	I

- The firm has no control over the time involved between stages A and B.
- The lag between D and E is determined by the production process and inventory policy.
- The time period between stages E and F is determined by the credit terms and the payments policy of Customers.

- A firm which purchases raw materials on credit is required by the credit terms to make payments within 30 days
- The firm allows it’s credit buyers to pay within 60 days. It's experience has been that it takes on an average 35 days to pay it’s Accounts Payable and 70 days to collect it’s accounts receivable.
- Further 85 days elapse between the purchase of raw material and sale of finished goods,i.e.average age of inventory is 85 days.
- Find out the the firm’s Cash Cycle?
- Also estimate the Cash Turnover.

- Cash Cycle = 85 Days+ 70 Days – 35 Days = 120 Days
- Cash Turn Over = Days in a Year/ Cash Cycle

  = 360/120 =3

Thus if the annual cash requirement of the firm is ₹240 Lakhs and Cash Turnover is 3 then the minimum cash requirement will be ₹240 Lakhs /3 = ₹80 Lakhs