

LEC-17

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BCA 2 Semester

Date

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Topic \rightarrow Working Capital

Definitions of working capital

According to Hoagland, "working capital is descriptive of that capital which is not fixed."

But the more common use of working capital is to consider it as the difference between the book value of the current assets and the current liabilities."

In general practice, "working capital refers to the excess of the current assets over current liabilities."

Nature and Scope of working Capital

The term working capital refers to current assets which may be defined as:

- 1) Those which are convertible into cash or equivalents with in a period

of one year.

- 2.) Those which are required to meet day to day operations.
- 3.) The fixed assets involve long period perspective whereas in working capital the time horizon is limited in general, to one year only.
- 4.) The fixed assets affect the long-term profitability of the firm while the current assets affect the short-term liquidity position.
- 5.) Managing current assets may require more attention than managing fixed assets.

Components of working capital.

There are two main components of working capital.

- 1) Current assets.
2) Current liabilities.

Current assets

- Inventories
- Trade debtors
- Prepaid expenses
- Loan and advances
- Investment
- Cash and bank balance

Current liabilities

- Sundry creditors
- Bank overdrafts
- Short-term loans

Provisions

These include provision for taxation, proposed dividends and contingencies

Thus the working capital of a business shows:

- The amounts of the firm's own

funds which have been used to finance the current assets after short-term borrowings have been deducted.

- The extent to which the business relies on short-term finance to pay for its current assets.

Classification of working capital.

working capital may be classified in two ways.

- 1.) on the basis of concept
- 2.) on the basis of time.

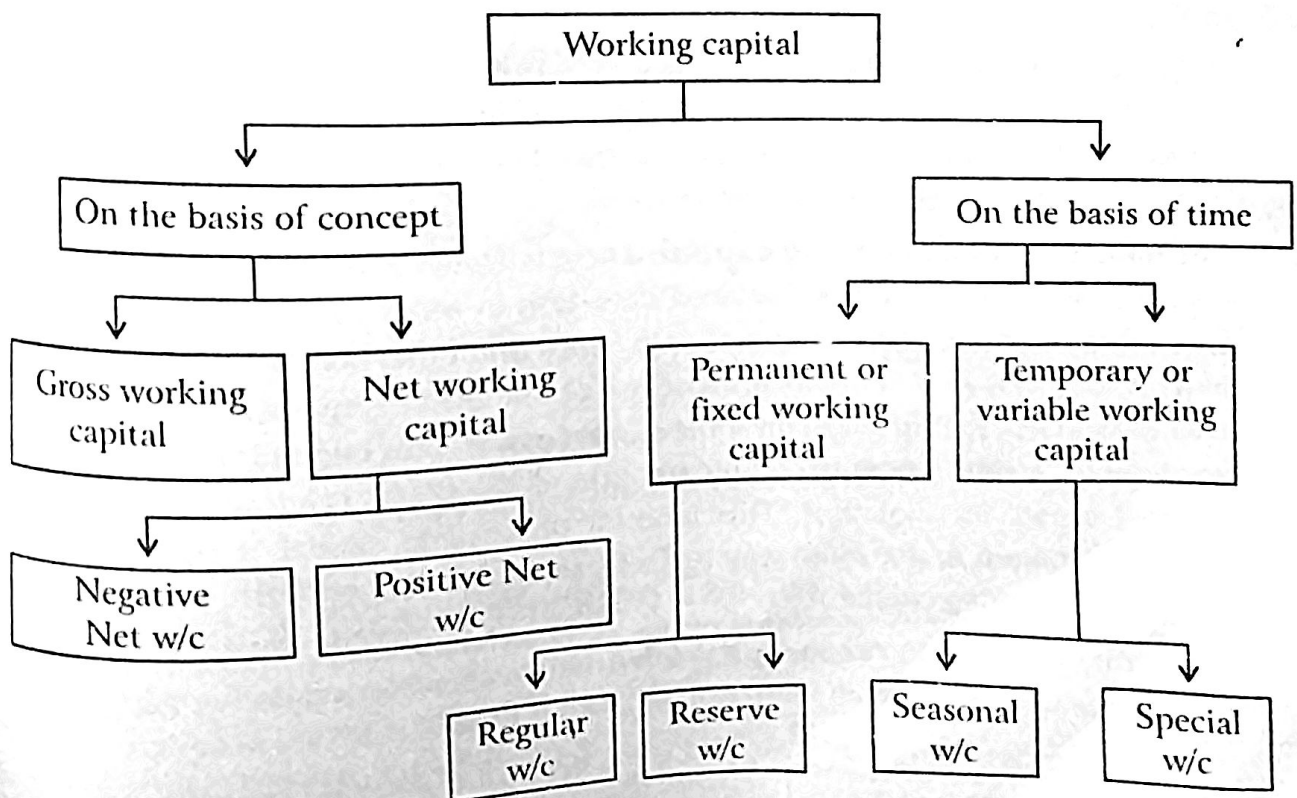


Fig. 1: Classification of working capital

on the basis of concept:

1.) Gross Working Capital or
total working capital. \Rightarrow The
gross working capital refers
to the firm's investment in all
the current assets taken
together.

The total of investment in all individual current assets is the gross working capital.

Gross working capital = Total investment in current assets.

Ex: if a firm has a cash balance of ₹ 50,000

debtors ₹ 70,000

Inventory and Raw material and finished goods has been assessed at ₹ 10,000

gross working capital of firm is ₹ 20,000 (i.e.) $(50,000 + 70,000 + 10,000)$

Net working capital This is divided into two form:

- 1) Positive Net working capital
- 2) Negative Net working capital.

• PNWC → If the total current assets are more than total current liabilities, then the difference is known as positive net-working capital.

Negative Net-working Capital.

If the total assets are less than total current liabilities, the difference is known as Negative net working capital.

$$\text{Net working Capital} = \text{Total current assets} - \text{total current lib.}$$