

Assignment - II

Explain the determinants of working capital

The determinants of working capital are factors that influence the amount of working capital a business needs to operate effectively. Working capital is the difference between a company's current assets (such as cash, accounts receivable & inventory) & its current liabilities (such as accounts payable & short term debts). Several factors can effect the required level of working capital.

Nature of Business:-

Companies involved in manufacturing typically require more working capital due to large investments in raw materials & inventories, while service based business might need less as they hold fewer inventories.

Business Cycle:-

During expansion phases, businesses may need more working capital to meet rising production & sales, while during recessions the need may decrease as production slows down.

Production Cycle:-

Companies with longer production cycle require more working capital to cover the costs of labor raw materials & overheads until goods are sold & cash is received.

Credit Policy:-

If a company offers longer credit periods to customers, it will need more working capital to cover the delay in receiving payment. Conversely if it can get favorable credit terms from suppliers, it may need less working capital.

Operating Efficiency:-

Firms that manage their inventory, accounts receivable & accounts payable efficiently can reduce the amount of working capital they require.

Market Conditions:-

In a competitive market, firms may need more working capital to finance promotions, discounts or maintain larger inventories to quickly meet customer demand.