

## ASSIGNMENT - II

Explain the determinants of working capital.

Determinants of working Capital Management requirements.

Firm Size, sales growth, profitability, Leverage, level of economic activities, operating cycle and the nature of the business.

Nature & Size of Business:-

Service  
Manufacturing

The nature & size of a business significantly influences its working capital needs. For example, a service-oriented company with minimal tangible assets/goods may demand less working capital than a retail business. This encompasses salaries, raw materials and maintaining inventory until products are sold. Larger manufacturing units, producing significant monthly units, require substantial working capital for seamless operations.

Sales and Revenue trends:-

The heart of working capital lies in the sales and revenue generated by a business. Analysing historical sales and revenue trend helps in forecasting future cash flow and adjusting working capital requirement.



## Inventory Management:-

Efficient inventory management is a key determinant of working capital. Balancing optimal stock level to meet customer demand while minimizing holding cost is a delicate art. Employing inventory turnover ratios and just in time practices can significantly impact working capital positively.

## Accounts Receivable:-

The speed at which a business can collect payments from customer directly affects working capital. A streamlined accounts receivable process, including effective credit management and timely invoicing, ensure a steady cash inflow.

## Account Payables:-

Managing accounts payable is equally crucial. Negotiating favourable credit terms with suppliers can contribute to an extended cash conversion cycle, positively impacting working capital.

## Credit Policy:-

A company's working capital requirements can be influenced by its credit and payment policies. Selling goods on credit may increase the need for working capital as the time taken to receive payments from accounts receivable can create a fund gap. Conversely, managing payables efficiently



Like implementing a credit policy allowing retailers one month for payment, signifies sufficient working capital to sustain operations during that period.

### Credit access.

Business with accessible credit during financial emergencies can efficiently function with reduced working capital. This is achievable because they can readily secure short-term loans when needed. Take, for example, a manufacturing company with a strong banking relationship, enabling easy access to short-term loans. This serves as a secure fallback option, allowing the company to approach the bank whenever faced with financial emergencies, thereby maintaining the necessary working capital levels for unforeseen situations.

### Debt Management:-

Balancing debt levels is critical for determining working capital. Excessive debt can strain cash flow, while strategic debt utilisation can provide additional capital for growth. Understanding the debt equity ratio and making informed financing decisions is key.