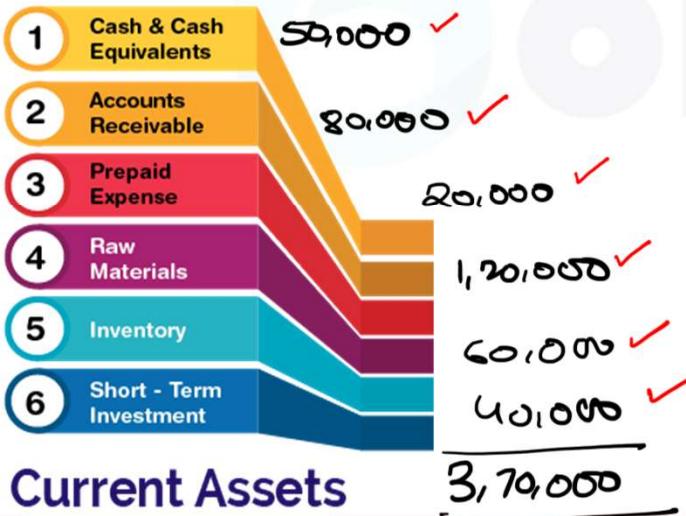


Working Capital

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

(Net of Depreciation)



CURRENT LIABILITIES

Cash dividends payable	10,000 ✓
Accrued expenses	10,000 ✓
Short-term notes payable	20,000 ✓
Accounts payable	40,000 ✓
Taxes payable	20,000 ✓
Unearned revenues	20,000 ✓
	<u>1,20,000</u> ✗



$$\text{Gross WC} = \underline{\underline{CA}} = \underline{\underline{3,70,000}}$$

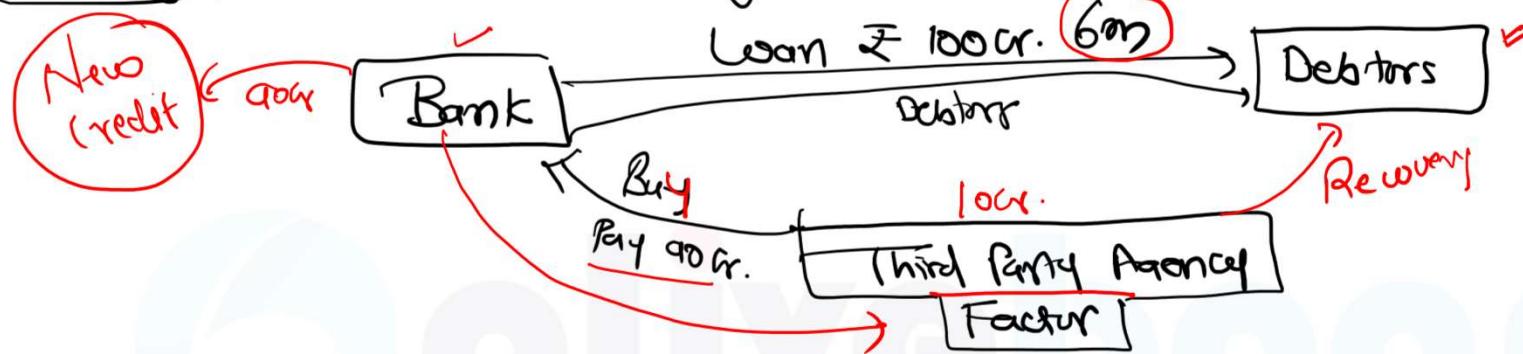
$$\text{Net WC} = \underline{\underline{CA - CL}} = \underline{\underline{3,70,000 - 1,20,000}} \\ = \boxed{\underline{\underline{2,50,000}}} \text{ ✗}$$

* Eg: CA = 3,70,000, CL = 1,20,000

$$\begin{aligned} \text{Dep.} &= 20,000 \\ \text{CA} - \text{Dep} &= \\ \text{NWC} &= 3,70,000 - 20,000 \\ &\quad - 1,20,000 \\ &= \boxed{2,30,000} \text{ ✗} \end{aligned}$$

TOPIC

Factoring \Rightarrow "Source of working Capital for financial institution"



Forfaiting \Rightarrow "if factoring happens in International trade" \Rightarrow

Debtors are outside India

TOPIC

Max. Permissible Bank Finance

Tandon committee

Maximum permissible bank finance (MPBF)

Three methods for determining MPBF

- Method 1: $MPBF = 0.75(CA - CL)$
- Method 2:** $MPBF = 0.75(CA) - CL$
- Method 3: $MPBF = 0.75(CA - CCA) - CL$

CA- current asset, CL- current liabilities,

CCA- core current assets (permanent component of working capital).

\Rightarrow Cash \approx
 \Rightarrow Stock \approx
 \Rightarrow min. value
 Req. to run
 Business

$① \underline{0.75 \cdot (CA - CL)}$ $\Rightarrow 0.75 \cdot (20L - 10L)$		$\underline{25\% \text{ of NWC}}$ by owner	Bank $7,50,000 \approx$	Owner $2,50,000 \approx$
$② \underline{(0.75 \cdot CA) - CL}$ $\Rightarrow (0.75 \cdot 20L) - 10L$ $* \underline{25\% \text{ of CA by owner}}$			$5,00,000 \approx$	$5,00,000 \approx$
$③ \underline{[0.75 \cdot (CA - CCA)] - CL}$ $\Rightarrow [0.75 \cdot (20L - 14L)] - 10L$			$2,00,000 \approx$	$8,00,000 \approx$

$$① \text{owner} = 25\% \cdot (CA - CL)$$

$$② \text{owner} = \boxed{25\% \cdot CA}$$

TOPIC



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Factors affecting Working Capital Requirement

Imp.

Current Assets Of A Firm

Current assets depends on various factors. The main factors that influence the need of working capital in a business are as under:

Nature of Business: Most Imp.

- Public utility undertakings such as electricity, water supply and railways require very little working capital finance because they sell their services on cash terms. They supply services not products, and very little funds are tied up in inventories and receivables.
- On the other hand, trading and financial firms require less investment in fixed assets but need large sums as working capital and fixed investments.

$$\begin{aligned}\Rightarrow \text{Public utility business} &= \text{Very low WC / Nominal WC} \\ \Rightarrow \text{Service business} &= \text{Low WC} \\ \Rightarrow \text{Manufacturer} &= \text{High WC}\end{aligned}$$

TOPIC

Size of the business:

$$\Rightarrow \begin{cases} \text{Big} = \text{more WC} \\ \text{Small} = \text{low WC} \end{cases}$$

- Greater the size of the business, greater is the requirement of working capital.

$$\Rightarrow \text{Static} = \text{more WC}$$

Production Policy:

$$\Rightarrow \text{Flexible} = \text{low WC}$$

- If the policy is to keep production steady-not geared to peak and non-peak nature of business-then there will be an accumulation of inventories in the off peak season.
- An average production level will help take care of this issue by ensuring the surplus of production in off peak season is disposed of during the peak season.

$$\Rightarrow \text{Season} = \text{more WC}$$

Seasonal variations:

$$\Rightarrow \text{Non-Season} = \text{low WC}$$

- Generally, during the busy season, a unit will require larger working capital than in slack season.

TOPIC

Operating/Working capital cycle:

\Rightarrow Big O. cycle = More WC
 \Rightarrow Small O. cycle = Low WC

- It is the duration of the operating cycle that determines the requirements of working capital.
- Longer the cycle larger is the requirement of working capital.
- The cycle duration decides the carry of inventory, the amount of labour and costs, and other expenses.
- **For example**, if the firm has to import raw material, it may have to maintain a bigger stock, to take care of supply disruptions.
- Similarly, if industry practice is to provide 3 months' credit to customers, it will also have to do so.

Unit 10

Derivatives

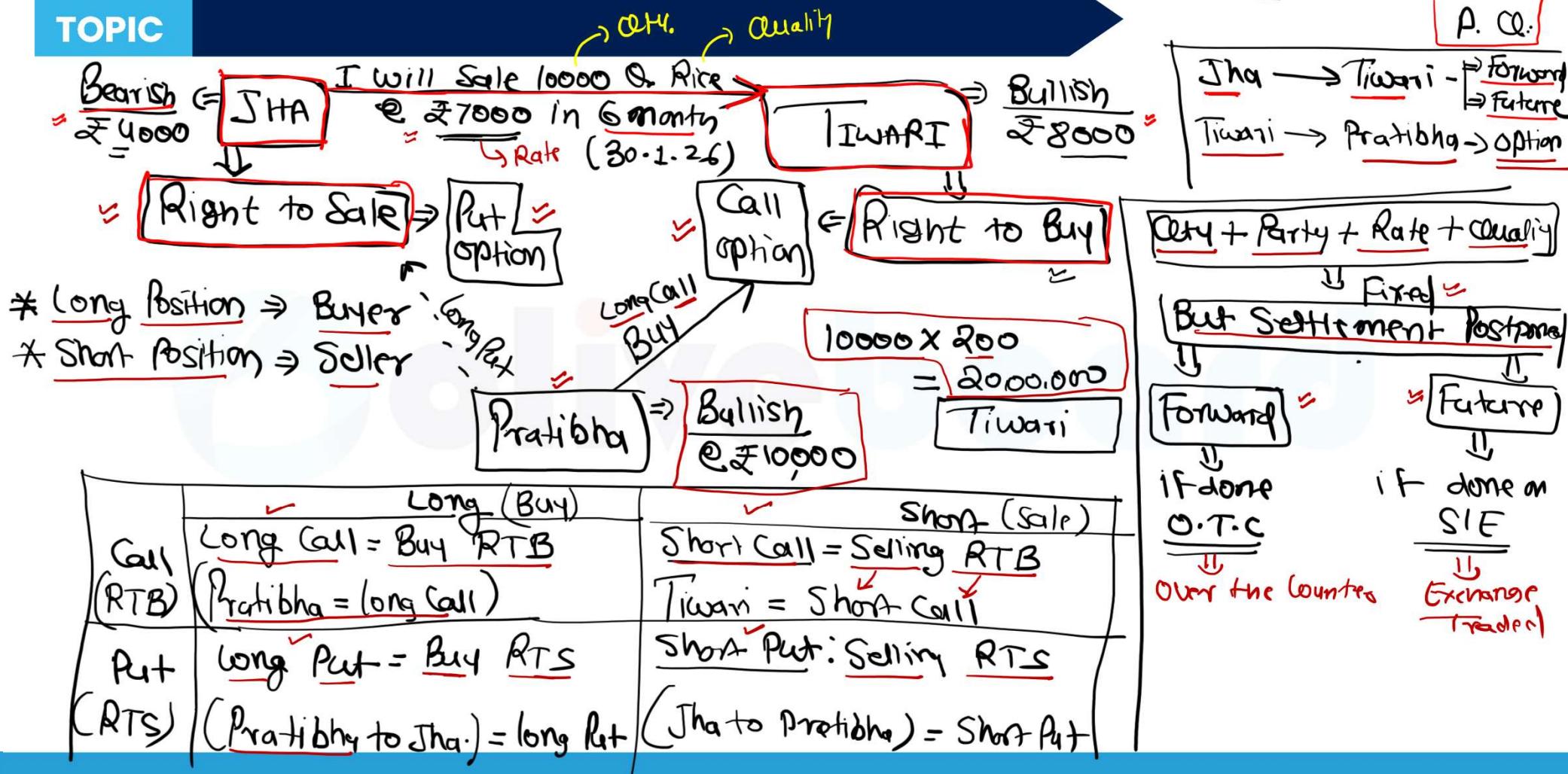
- ⇒ Forward ✓
- ⇒ Futures ✓
- ⇒ Options ✓
- ⇒ Swap ✓

- ⇒ Bond ✓
- ⇒ Petrol ✓
- ⇒ Interest ✓
- ⇒ Share Price ✓
- ⇒ Inflation ✓

ee financial instrument which derives its value from some "Underlying Asset"

- ⇒ Bond ✓
- ⇒ Petrol Bond ✓
- ⇒ Interest linked Bond ✓
- ⇒ Indexed Bond ✓
- ⇒ Inflation Bond ✓

TOPIC



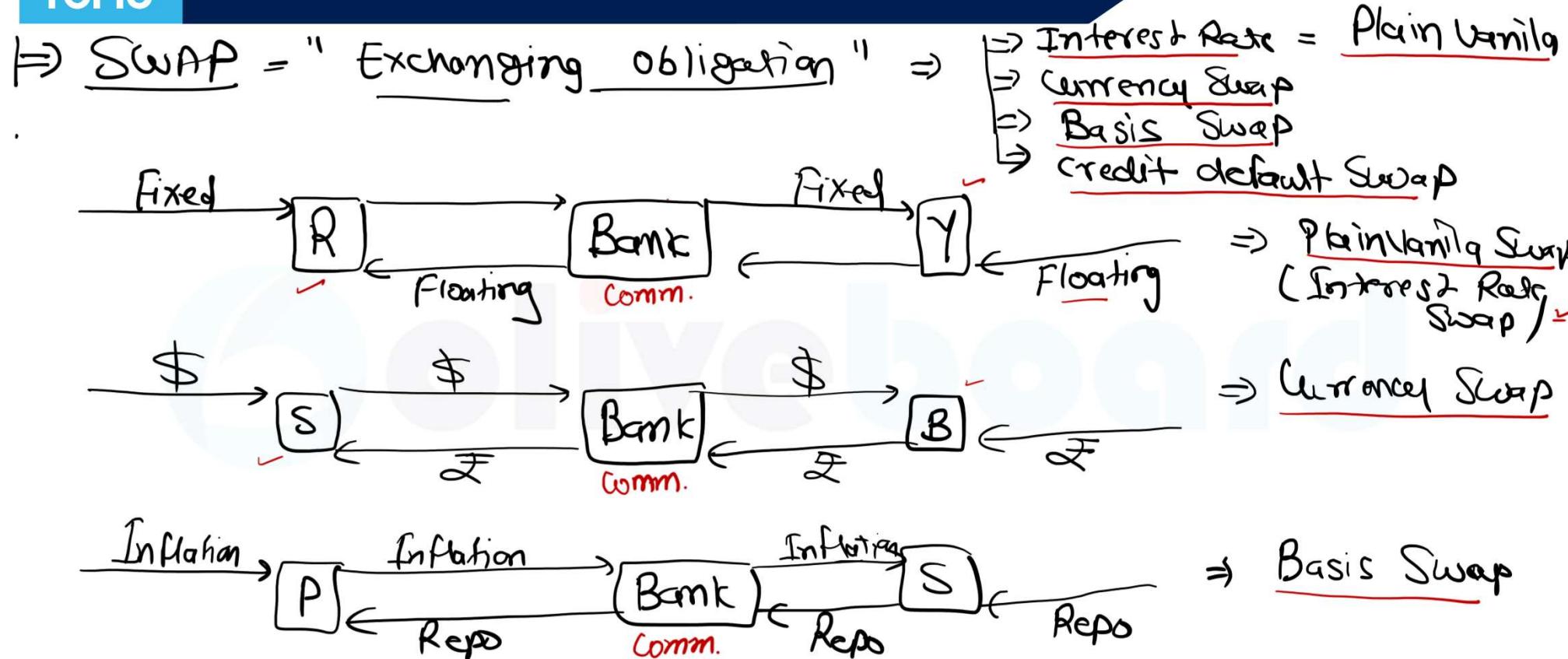
TOPIC



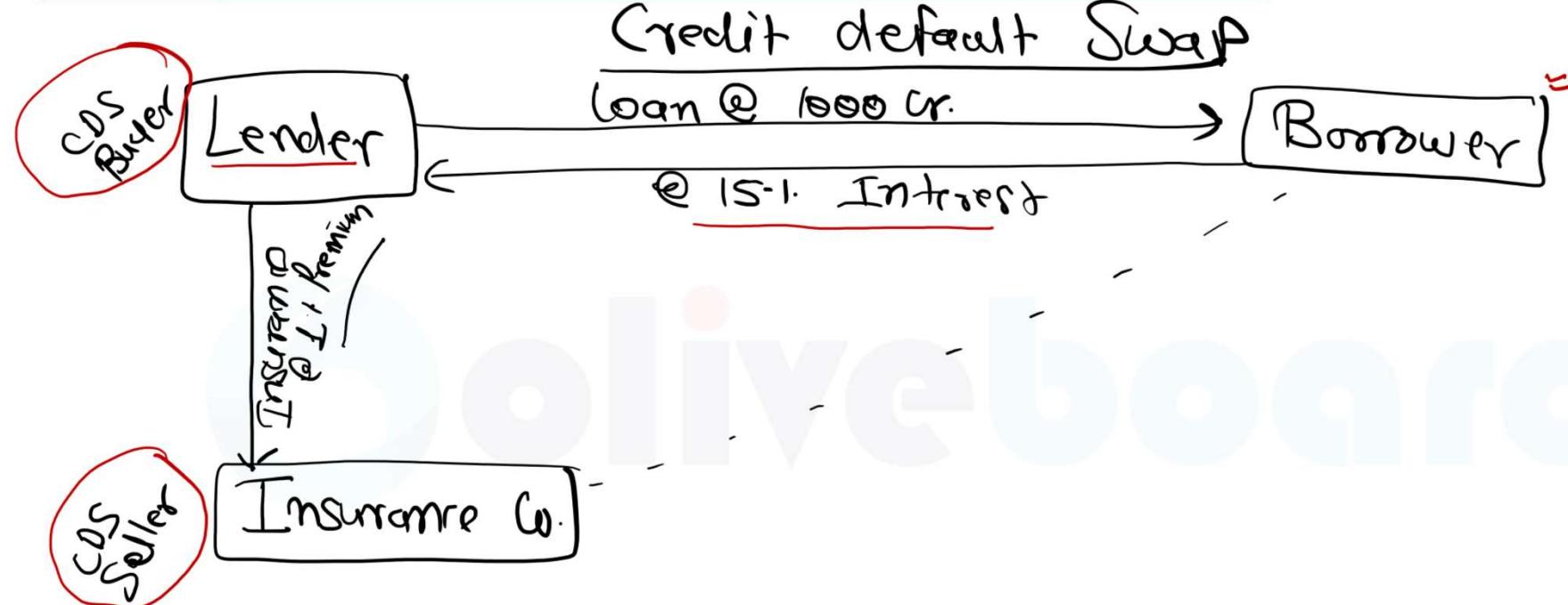
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TOPIC



TOPIC

Forward

- ✓ Fixed
- ✓ Fixed
- ✓ Fixed
- ✓ Fixed



Future

- Fixed ✓
- Fixed ✓
- Fixed ✓
- Fixed ✓

Stock Exchange

- Standard ✓
- Less Risky ✓
- High liquidity ✓
- Regulated ✓

Over the Counter

- Non Standard ✓
- Risky ✓
- Liquidity low ✓
- Unregulated ✓

TOPIC

INTRODUCTION :-

A derivative is a financial instrument whose value is derived from an underlying asset. ✓

Derivative means an instrument, to be settled at a future date, whose value is derived from change in interest rate, foreign exchange rate, credit rating or credit index, price of securities

DERIVATIVES MARKETS

- Over-the-counter (OTC) derivatives: not standardised and are mutually agreed to between the parties to a contract.
- Exchange-traded derivatives

REGULATORS OF DERIVATIVES:-

- (RBI) ⇒ Interest Rate related ✕
- (SEBI) ⇒ other derivatives
- Forward Markets Commission FMC regulates commodities futures market. Forward Markets Commission (FMC) has been merged with SEBI with effect from September 28, 2015.

TOPIC

- **Forwards** ✓
- **Futures** ✓
- **Options** ✓
- **Swaps**:- exchange one thing for another or 'barter'. ✓
 - **Interest Rate Swap:** ✓
 - **Currency Swap:** ✓
 - **Basis Swaps:** ✓

TOPIC

IMPORTANT DERIVATIVE PRODUCTS IN INDIAN FINANCIAL MARKET

Forward Rate Agreement (FRA):- a contract between two parties by which they agree to settle between them the interest differential on a notional principal on a future settlement date for a specified future

Salient Points of FRA:-

- A FRA is a forward contract on the interest rate. ✓
 - As FRAs are OTC contracts, ✓
 - Forward Rate Agreements are used to hedge short term interest rate risk.
 - FRAs do not enjoy very liquid markets.
 - They are very useful in Asset Liability Management.
- Fixing the Risk / Fixing Max. loss
- ↓
- | | | | |
|--------------|---------------|-----------|--------------|
| <u>I</u> | <u>Call</u> ↗ | <u>II</u> | <u>Put</u> ↗ |
| <u>Put</u> ↗ | <u>Call</u> ↗ | | |

TOPIC

- **Plain Vanilla Interest Rate Swaps:-** A Plain Vanilla Swap is the simplest form of Interest rate swaps where a fixed rate is exchanged for a floating rate or vice versa on a given notional principal at pre-agreed intervals, during the life of the contract.