

Working Capital

$$\text{Working Capital} = \text{Current Assets (Net of Depreciation)} - \text{Current Liabilities}$$



1	Cash & Cash Equivalents	50,000 ✓
2	Accounts Receivable	80,000 ✓
3	Prepaid Expense	20,000 ✓
4	Raw Materials	1,20,000 ✓
5	Inventory	60,000 ✓
6	Short - Term Investment	40,000 ✓
Current Assets		3,70,000

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 ✓
	1,20,000 ✓

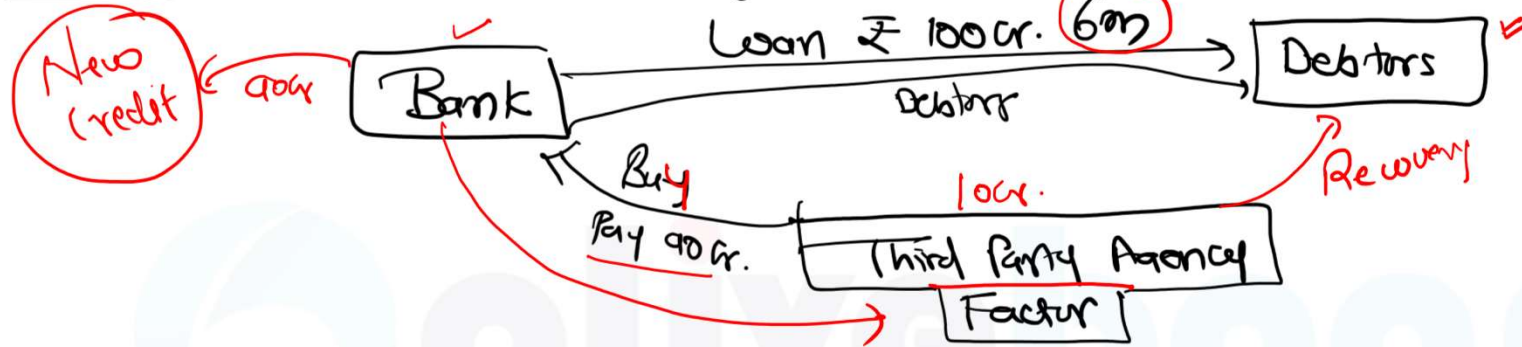
$$\text{Gross WC} = \text{ECA} = \underline{3,70,000}$$

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

* Eg: CA = 3,70,000, CL = 1,20,000
 $\Rightarrow \text{Dep.} = 20,000$
 $\text{Net WC} = \text{CA} - \text{Dep} - \text{CL}$
 $= 3,70,000 - 20,000 - 1,20,000 = \underline{2,30,000} \checkmark$

TOPIC

Factoring ⇒ "Source of working Capital for financial Institution"



Forfeiting ⇒ "if factoring happens in International trade" ⇒ Debtors are outside India

TOPIC

Max. Permissible Bank Finance

eg:- $CA = 20L$ | $NWC = CA - CL$
 $CL = 10L$ $\Rightarrow 20L - 10L$
 $\Rightarrow CCA = 4L$ $= 10,00,000$

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 \Rightarrow min. Value
 \Rightarrow Stock \Rightarrow Req. to run Business

① $75\% (CA - CL)$ $\Rightarrow 75\% (20L - 10L)$ $\Rightarrow 75\%$ of NWC by owner

② $(75\% CA) - CL$ $\Rightarrow (75\% \text{ of } 20L) - 10L$
 $\Rightarrow 25\% \text{ of } CA \text{ by owner}$

③ $[75\% (CA - CCA)] - CL$ $\Rightarrow [75\% \text{ of } (20L - 4L)] - 10L$

Bank	Owner
7,50,000	2,50,000
5,00,000	5,00,000
2,00,000	8,00,000

① owner = $25\% (CA - CL)$

② owner = $25\% CA$

TOPIC



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.
- ⇒ Public utility business = Very low wc / Nominal wc
⇒ Service business = low wc
⇒ Manufacturer = High wc

Size of the business: $\Rightarrow \begin{cases} \Rightarrow \text{Big} = \text{more WC} \\ \Rightarrow \text{Small} = \text{low WC} \end{cases}$

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

Production Policy: $\Rightarrow \begin{cases} \Rightarrow \text{Static} = \text{more WC} \\ \Rightarrow \text{Flexible} = \text{low WC} \end{cases}$

- 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.

Seasonal variations: $\Rightarrow \begin{cases} \Rightarrow \text{Season} = \text{more WC} \\ \Rightarrow \text{Non-Season} = \text{low WC} \end{cases}$

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

Operating/Working capital cycle: = $\begin{cases} \Rightarrow \text{Big O.Cycle} = \text{More WC} \\ \Rightarrow \text{Small O.Cycle} = \text{low WC} \end{cases}$

- 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 ✓

- ⇒ Gold ✓
- ⇒ Petro ✓
- ⇒ Interest ✓
- ⇒ Share Price ✓
- ⇒ Inflation ✓

ee Financial Instrument which derives its value from some "Underlying Asset"

- ⇒ Gold Bond ✓
- ⇒ Petro Bond ✓
- ⇒ Interest linked Bond ✓
- ⇒ Indexed Bond ✓
- ⇒ Inflation Bond ✓

TOPIC

Bearish \Rightarrow JHA \Rightarrow I will sell 10000 Q. Rice @ ₹7000 in 6 months \Rightarrow Bullish \Rightarrow TIWARI \Rightarrow ₹8000
 ₹4000 \Rightarrow Rate (30.1.26)

Right to Sell \Rightarrow Put option

Call option \Rightarrow Right to Buy

* Long Position \Rightarrow Buyer
 * Short Position \Rightarrow Seller

Long Call Buy

Pratibha \Rightarrow Bullish @ ₹10000

10000 x 200 = 2000.000
 Tiwari

	Long (Buy)	Short (Sale)
Call (RTB)	Long Call = Buy RTB (Pratibha = long Call)	Short Call = Selling RTB Tiwari = Short Call
Put (RTS)	Long Put = Buy RTS (Pratibha to Jha) = long Put	Short Put: Selling RTS (Jha to Pratibha) = Short Put

* Rice Today = ₹6000
 A. Q.

Jha \rightarrow Tiwari \Rightarrow Forward
 Tiwari \rightarrow Pratibha \Rightarrow Option

City + Party + Rate + Quality

But Settlement Postpone

Forward

if done
 O.T.C

Over the Counter

Future

if done on
 SIE

Exchange
 Traded

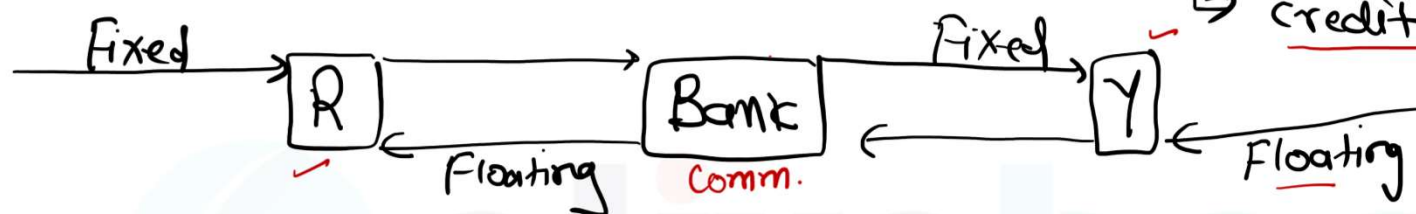
TOPIC



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⇒ SWAP = "Exchanging obligation" ⇒

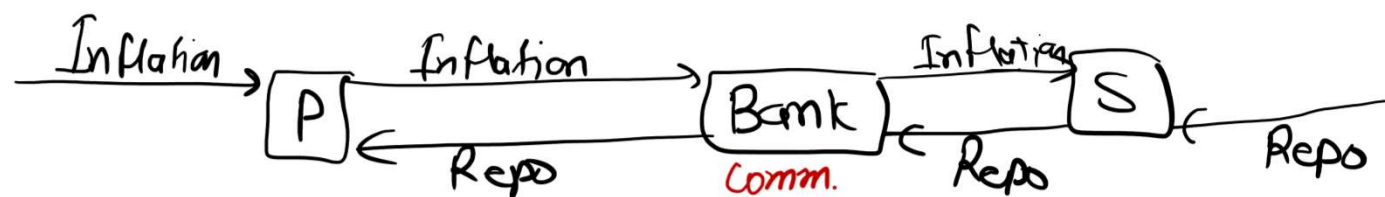
- ⇒ Interest Rate = Plain Vanilla
- ⇒ Currency Swap
- ⇒ Basis Swap
- ⇒ Credit default Swap



⇒ Plain Vanilla Swap
(Interest Rate Swap)

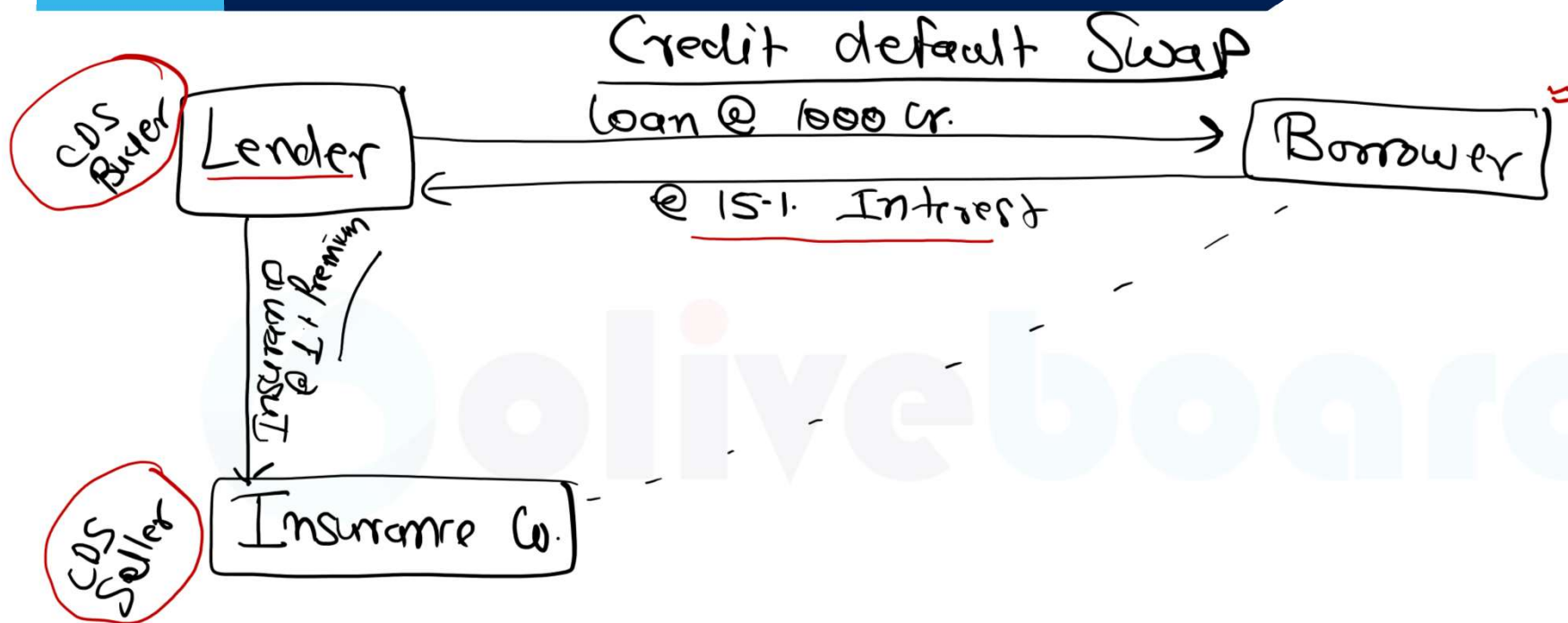


⇒ Currency Swap

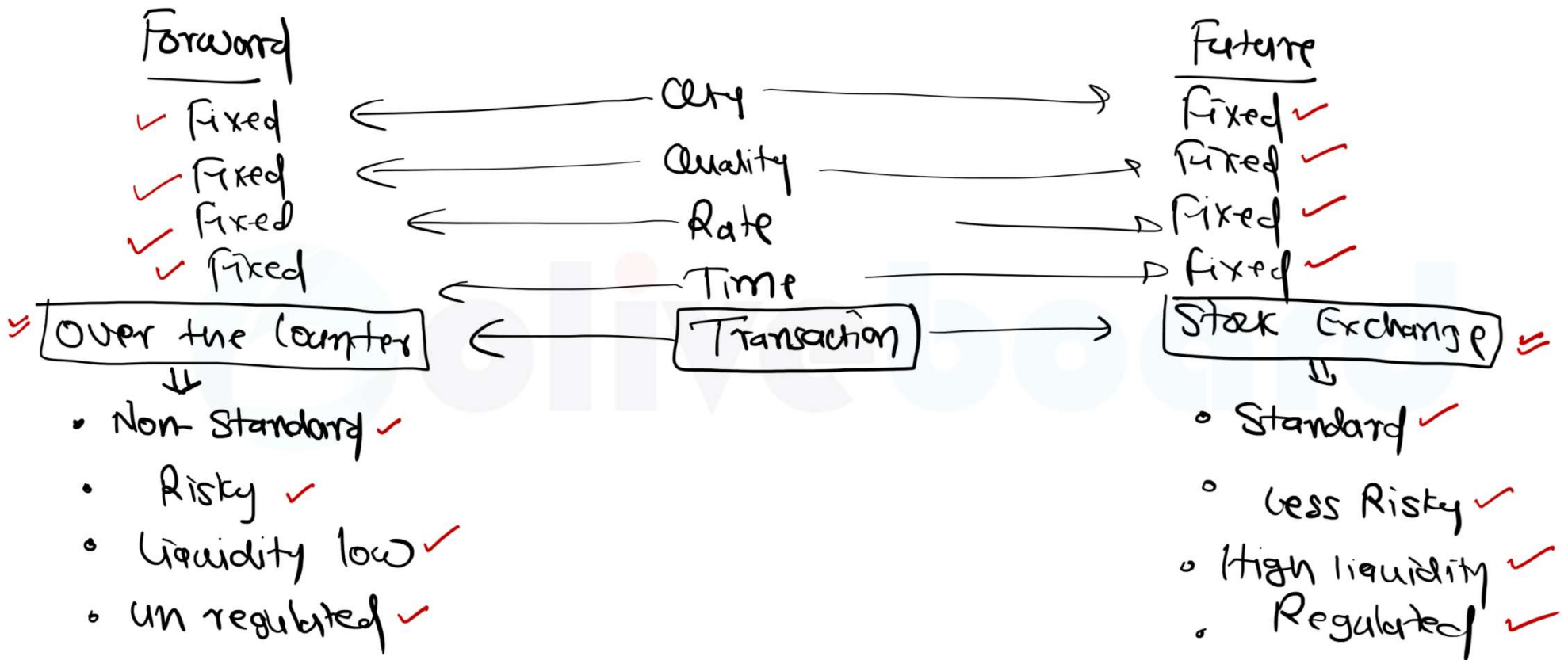


⇒ Basis Swap

TOPIC



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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:** ✓

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. ^{→ Fixing the Risk / Fixing max. loss}
- FRAS do not enjoy very liquid markets.[↓]
- They are very useful in Asset Liability Management.^{✓✓}

I	II
<u>Call</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.

