Summary

Working Capital Management

Managing current/short-term funds is critical for the long-term success of any venture. Working Capital Management or in simple words ensuring adequate short-term liquidity is important in order to meet current business obligations, and in the process ensuring survival of the business.

Introduction to Working Capital

Every commercial organisation has day to day expenses like labour cost, the cost of buying inventories, etc. Sufficient liquidity must be maintained in order to service these small yet significant liabilities. Such funds are typically called "Working Capital" and are maintained as a Current Asset of the business.

Working Capital has two major components. They are:

1. Permanent Working Capital – that which remains stable over a period of time, and is predictable to some extent. This has to be estimated basis the plans of the business.
2. Fluctuating Working Capital – that which allows fluctuations over the period depending upon the needs and requirements of the business, and allows the business to take advantages of sudden opportunities that might come its way.

There are many factors that influence the working capital needs of an organisation. Some of these factors are:

1. Nature of Business
2. Size of Business
3. Production Cycle
4. Type of Industry
5. Business Fluctuations
6. Access to Banking Facilities
7. Profit and Taxes

Operating Cycle

The understanding of working capital becomes easy when you look into a company's operating cycle. The cycle starts with the purchase of raw materials by paying cash. Then, the raw materials are converted into work-in-progress (WIP) and then to finished goods through value addition. The cycle moves on to the next stage when finished goods are sold to customers. The cycle ends with cash when money is realised from customers at the end of the credit period.

The concept is helpful in understanding, and accurately estimating the working capital needs of the business.

Financing and Management of Working Capital

Once the short-term fund requirement of the business has been estimated, the organisation needs to organise these funds. There are several routes by way of which this can be done. It can be financed by the venture's short term liabilities/obligations or in some cases; this can even be financed through long-term sources like Debt or Equity.

It is necessary that these short-term funds are utilised in the most efficient manner, and if not done well, this often becomes the root cause for the downfall of startups with good potential. Following are the tips that will help you efficiently manage your working capital needs:

- Maintain current assets that liquidate into cash quickly, when needed
- Increase efficiency of the operating cycle, by reducing the time it takes from "Raw Material" to "Cash."
- Manage your receivables/payables better, by limiting the credit period you offer to clients, and trying to enhance the credit period you take from suppliers
- Manage your inventory, by liquidating more than you store

Vendor Contracts

It's critical to have mutually agreeable vendor contracts in order to build a healthy and long term relationship with them. The terms and conditions of these contracts need to be pre-decided so as to avoid any conflicts in future. Following are the key aspects that need to be negotiated and included in such contracts:

- Fees, Costs, and Expenses

- Payment Terms
- Applicability of Taxes
- Scope of Services
- Termination
- Financial Covenants

You should be able to:

At the end of this session, you should be able to:

- Understand the importance of maintaining short-term liquidity in your venture
- Estimate the requirement of working capital for your business venture
- Manage working capital and how to get it financed
- Develop mutually agreeable vendor contracts for your business