

DPBS(PG) College, Anoopshahr

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WORKING CAPITAL MANAGEMENT DEFINITION

The term 'working capital management' primarily refers to the efforts of the management towards effective management of current assets and current liabilities. Working capital is nothing but the difference between the current assets and current liabilities. In other words, an efficient working capital management means ensuring sufficient liquidity in the business to be able to satisfy short-term expenses and debts.

In a broader view, 'working capital management' includes working capital financing apart from managing the current assets and liabilities. That adds the responsibility for arranging the working capital at the lowest possible cost and utilizing the capital cost-effectively.

OBJECTIVES OF WORKING CAPITAL MANAGEMENT

The primary objectives of working capital management include the following:

- **Smooth Operating Cycle:** The key objective of working capital management is to ensure a smooth operating cycle. It means the cycle should never stop for the lack of liquidity whether it is for buying raw material, salaries, tax payments etc.
- **Lowest Working Capital:** For achieving the smooth operating cycle, it is also important to keep the requirement of working capital at the lowest. This may be achieved by favorable credit terms with accounts payable and receivables both, faster production cycle, effective inventory management etc.

- **Minimize Rate of Interest or Cost of Capital:** It is important to understand that the interest cost of capital is one of the major costs in any firm. The management of the firm should negotiate well with the financial institutions, select the right mode of finance, maintain optimal capital structure etc.
- **Optimal Return on Current Asset Investment:** In many businesses, you have a liquidity crunch at one point of time and excess liquidity at another. This happens mostly with seasonal industries. At the time of excess liquidity, the management should have good short-term investment avenues to take benefit of the idle funds.

IMPORTANCE OF EFFECTIVE WORKING CAPITAL MANAGEMENT

Although the importance of working capital is unquestionable in any type of business. Working capital management is a day to day activity, unlike capital budgeting decisions. Most importantly, inefficiencies at any levels of management have an impact on the working capital and its management. Following are the main points that signify why it is important to take the management of working capital seriously.

- Ensures Higher Return on Capital
- Improvement in Credit Profile & Solvency
- Increased Profitability
- Better Liquidity
- Business Value Appreciation
- Most Suitable Financing Terms
- Interruption Free Production
- Readiness for Shocks and Peak Demand
- Advantage over Competitors